

## Treasury Management and Investment Strategies, Prudential and Financial Health Indicators

### 1 Summary

#### 1.1 This Appendix:-

- outlines a proposed Treasury Management Strategy for the management of the Council's debt portfolio;
- sets an Annual Investment Strategy for the investment of the Council's surplus funds;
- states the Council's policy on Minimum Revenue Provision; and
- in accordance with the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code, sets the Council's prudential indicators for next year and beyond which relate to borrowing and other aspects of treasury management, together with a number of other financial health indicators.

#### 1.2 This Appendix recommends to the County Council that:

- **the Treasury Management Strategy for 2010/11 be approved;**
- **a guideline annual target of up to £17m be set for 2010/11 to 2012/13 for new long-term fixed-rate borrowing, which can be exceeded if circumstances are appropriate;**
- **the Annual Investment Strategy described in section 14 be approved;**
- **the County Council delegates responsibility for the execution and administration of all treasury management activities to the County Treasurer, who will act in accordance with this Treasury Management Strategy;**
- **the policy on Minimum Revenue Provision as set out in section 15 be approved; and**
- **the prudential indicators, treasury management indicators and other financial health indicators be approved.**

### 2 Planned capital expenditure and capital financing requirement 2010/11 to 2012/13

#### 2.1 Table 1 sets out actual capital expenditure incurred in 2008/09 and

estimated capital expenditure in the current and future years to 2012/13, based on the capital programme submitted to the Cabinet for approval. The table also identifies the extent to which capital expenditure is planned to be financed from supported and prudential borrowing.

**Table 1: Capital Expenditure and Resources**

	2008/09 Actual £m	2009/10 Estimate £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
<b>Total capital payments</b>	<b>193.6</b>	<b>185.6</b>	<b>199.3</b>	<b>137.9</b>	<b>86.6</b>
Resources:-					
Supported borrowing	16.4	53.8	56.8	24.9	4.4
Prudential borrowing	47.3	7.6	3.2	2.5	0.4
Less repayments from capital receipts etc.	-2.4	-6.3	-9.6	-29.8	-7.8
Capital grants	66.6	55.6	87.8	55.0	36.4
External contributions	11.8	14.6	18.9	18.1	15.2
Capital receipts	2.4	11.5	13.0	42.5	8.5
Contributions from reserves	0.7	1.1	0.1	0.0	0.0
Revenue contributions	39.1	40.6	28.5	24.6	29.1
less transfers to/from the capital reserve	11.7	7.1	0.6	0.1	0.4
<b>Total capital resources</b>	<b>193.6</b>	<b>185.6</b>	<b>199.3</b>	<b>137.9</b>	<b>86.6</b>

- 2.2 Based on the capital expenditure plans set out in Table 1, the capital financing requirement is forecast to increase from £653.5m at 1 April 2010 to £671.3m at 31 March 2013, as set out in Table 2 below.

- 2.3 The capital financing requirement represents capital expenditure which has not been financed from capital receipts, the revenue budget, capital grants or external contributions. This can be financed either from external borrowing or by borrowing from internal balances.
- 2.4 Provision for the repayment of debt is charged to the revenue account based on a Minimum Revenue Provision (MRP), in most cases based on 4% of the capital financing requirement. The Council's policy on MRP to repay debt is covered in section 15.
- 2.5 The County Council has entered into a Private Finance Initiative (PFI) contract for the design, installation, operation and maintenance of street lighting in Hampshire over a 25-year period, commencing on 1 April 2010. Under International Financial Reporting Standards (IFRS), the assets created within most local authority PFI projects will in future need to be included in the local authority balance sheet together with the liability in respect of those assets to the PFI contractor. The asset and liability associated with the Street Lighting PFI will therefore need to be included within the relevant County Council prudential indicators in future, effectively as capital expenditure financed by an alternative form of Government supported borrowing. This report makes allowance on an estimated basis for the impact of the Street Lighting PFI on the prudential indicators over the next three years. The contract provides for the replacement of a substantial proportion of existing street lighting columns over the next five years, so the value of the PFI liability will build up over the early years of the contract to a level above £100m, which will then be repaid over the remaining period of the contract, with the benefit of PFI government grant.

**Table 2: Capital financing requirement**

	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
Capital financing requirement at the beginning of the year:			
County Council	614.5	646.9	637.8
Managed on behalf of external bodies	39.0	37.3	35.6
	<b>653.5</b>	<b>684.2</b>	<b>673.4</b>
New borrowing (as per Table 1)	60.0	27.5	4.8
Street Lighting PFI	7.3	19.7	27.8

## Appendix 8

	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
Repayment from revenue account and external bodies based on the minimum revenue provision	-27.0	-28.1	-26.9
Special capital repayments arising from repayment of prudential borrowing	-9.6	-29.9	-7.8
Capital financing requirement at year end	<b>684.2</b>	<b>673.4</b>	<b>671.3</b>

2.6 Table 3 analyses the capital financing requirement between borrowing supported by the Government through the formula grant system and prudential borrowing. In normal circumstances, the focus of the County Council's consideration of the affordability of borrowing for capital purposes would be focussed on the level of prudential borrowing, as increases in the cost of supported borrowing from additional Government borrowing allocations would be matched by additional formula grant. However, this is not currently the case as the County Council's grant is determined by the criteria for setting a 'grant floor' rather than the formula itself.

2.7 The County Council's current policy on the take up of supported borrowing in setting the base budget is to limit the increase in the capital financing requirement relating to supported borrowing to 2.5% per annum, with any additional take up of supported borrowing being subject to a review of priorities within the overall budget strategy.

**Table 3: Capital financing requirement between supported and prudential borrowing**

At 31 March	2009 Actual £m	2010 Estimate £m	2011 Estimate £m	2012 Estimate £m	2013 Estimate £m
Supported borrowing:-					
- County Council	485.4	518.5	553.6	553.8	535.1
- Other bodies	40.8	39.0	37.3	35.6	33.9
- Street Lighting PFI	0.0	0.0	7.3	27.0	54.8

## Appendix 8

At 31 March	2009 Actual £m	2010 Estimate £m	2011 Estimate £m	2012 Estimate £m	2013 Estimate £m
Prudential borrowing	97.8	96.0	86.0	57.0	47.5
<b>TOTAL</b>	<b>624.0</b>	<b>653.5</b>	<b>684.2</b>	<b>673.4</b>	<b>671.3</b>

2.8 Table 4 analyses the prudential element of the capital financing requirement between categories.

**Table 4: Analysis of the prudential element of the capital financing requirement between categories**

At 31 March	2009 Actual £m	2010 Estimate £m	2011 Estimate £m	2012 Estimate £m	2013 Estimate £m
Schemes to be financed from savings in the revenue budget	42.3	43.9	42.4	41.7	38.3
Temporary borrowing on specific projects to be repaid from capital receipts / developer contributions	54.4	50.1	41.6	13.4	7.0
Trading unit capital investment financed from future charges	1.1	2.0	2.0	1.9	1.8
General temporary borrowing to meet short term capital resource shortfalls	0.0	0.0	0.0	0.0	0.4
<b>TOTAL</b>	<b>97.8</b>	<b>96.0</b>	<b>86.0</b>	<b>57.0</b>	<b>47.5</b>

2.9 The proposals for prudential borrowing in 2010/11 and subsequent years are the result of the application of the County Council's policy

on the use of prudential borrowing under the Prudential Code. Projects fall within four categories contained in the policy:-

- borrowing over a period of up to 10 years on an 'invest to save' basis where the capital project is expected to generate cash savings, increased income or the avoidance of otherwise unavoidable costs, which will enable the service's revenue cash limit to be reduced in order to accommodate the financing costs within the budget;
- temporary prudential borrowing pending the availability of capital receipts, grants or contributions, which will enable the borrowing to be repaid, including any interest costs not met from within the service revenue budget. Prudential borrowing for a number of school projects in advance of capital receipts or developer contributions and the Ashburton Court refurbishment, together with a number of other specific projects have been agreed in accordance with this policy. Since 2006/07 the County Council's policy requires service budgets to cover interest costs and minimum revenue provision from the revenue budget rather than rolling it up to be financed from the eventual capital receipt;
- use of prudential borrowing to finance business unit capital expenditure where the financing costs will be recovered in charges made to users and met from their existing budgets. IT Services' use of prudential borrowing was approved in accordance with this policy;
- in addition to the use of temporary prudential borrowing to fund specific projects, as a result primarily of the downturn in the property market, some additional temporary prudential borrowing is also forecast to be required between 2010/11 and 2012/13.

### **3 Further long-term borrowing**

- 3.1 Table 2 shows that over the three-year period to March 2013, an increase in the capital financing requirement of £17.8m from £653.5m to £671.3m is forecast based on the current and proposed capital programme.
- 3.2 A balance needs to be drawn in the debt portfolio between long-term debt at fixed interest rates from the PWLB and other sources and debt where interest is payable at variable rates. Fixed-rate long-term debt means that interest costs are more stable and less vulnerable to changes in interest rates. Short-term debt is sensitive to changes in interest rates and enables savings to be made when interest rates fall but means higher costs when they rise.
- 3.3 If no further fixed-rate long-term borrowing takes place between now

and the end of March 2010, some 58% of the capital financing requirement will be held at variable interest rates. If no further long-term borrowing were to take place by March 2013, this proportion would remain unchanged at 58% (excluding the Street Lighting PFI). To move to a target fixed/variable rate ratio of 50%/50%, some £50m would need to be borrowed long-term at fixed rates between now and March 2013, implying a target of around £17m a year.

### **4 Interest rate trends**

- 4.1 The Base Rate had remained unchanged at 0.5% since it was last reduced in March 2009, its lowest level since the Bank of England was formed in 1694.
- 4.2 Whilst inflation as measured by the Consumer Price Index (CPI) for December 2009 rose sharply to 2.9% from its November 2009 figure of 1.9%, a number of market forecasters (not least the Bank of England itself) expect this surge in inflation to be temporary and slow in coming months as inevitable fiscal tightening acts as a dampener on prices.
- 4.3 Based on 25-year term fixed-rate maturity PWLB loans, long-term borrowing rates have fluctuated considerably over the past year although have averaged around 4.5%. Initially rising from 4.0% in early January 2009, they peaked at around 4.8% in June 2009 before falling back to 4.1% in October 2009, before rising again to their current rate of around 4.5%.
- 4.4 It is envisaged that longer-term interest rates will remain on a stable path over the next year at around 4.5%, although recent concern over the UK Government's indebtedness threatening its AAA sovereign rating status may lead to an increase in such long-term borrowing costs over time.
- 4.5 From a short-term investment interest rate perspective, a weak economic recovery limits the requirement for the Base Rate to increase from its current level of 0.5%. Nonetheless, market forecasts would seem to indicate a Base Rate level of 1.0%, 2.0% and 3.0% by the ends of 2010, 2011 and 2012 respectively.

### **5 Lender's option/borrower's option loans (LOBOs)**

- 5.1 Over recent years, the commercial money market has endeavoured to offer loan products to local authorities which are competitive with those available from the PWLB. Since June 2002, lender's option/borrower's option loans (LOBOs) have been of particular interest as an alternative form of borrowing in order to generate short-term savings in interest costs.
- 5.2 A standard LOBO means taking out a long-term loan for an initial primary period (normally between one and three years) at a

preferential fixed interest rate, followed by a higher rate for the remaining period of the loan. 'Single-rate only' LOBOs are also available, where the rate over the primary period is the same as that for the remaining period. In both instances, the lender can choose to increase the rate at the end of the primary period and every six months or annually thereafter. If the lender increases the rate, the Council as a borrower can choose to repay the loan.

- 5.3 LOBO loans can generate short-term savings in borrowing costs over the initial primary periods. However, such loans will track any upward movement in long-term interest rates and may therefore equate to higher future long-term borrowing costs. Unlike long-term fixed rate PWLB loans, LOBOs cannot provide guaranteed long-term interest rate stability. Whilst the Council has a choice over repaying the LOBO loan when the lender opts to increase the relevant interest rate, it will ultimately need to re-finance this by taking out a replacement loan at prevailing borrowing rates.
- 5.4 In 2006/07, it was agreed to set a 15% limit on the proportion of the Council's capital financing requirement to be financed from LOBOs. This forms part of the variable rate target of 50% (see paragraph 3.3).
- 5.5 For information, the Council currently has a total of £73m LOBOs at interest rates ranging between 3.89% and 5.0% and an average overall rate of 4.45%.
- 5.6 However, LOBO loan rates have risen relative to PWLB rates and currently do not offer any competitive advantage due to the lack of availability of credit within the banking system. As a result, no new LOBO loan finance has been taken out during 2009/10.
- 5.7 Whilst LOBO finance will be kept under review, all new external borrowing for 2010/11 is expected to be obtained from the PWLB whilst such restrictive credit conditions persist within the banking sector.

## **6 Fixed-rate borrowing strategy**

- 6.1 In line with the Council's established policy of taking loans in small tranches, six new fixed-rate loans totalling £12m with an average duration of 25 years have been taken out from the PWLB since March 2009. The fixed rates ranged between 3.97% and 4.50%, averaging 4.23%.
- 6.2 In addition to the above, a further loan for £2m was taken out from the PWLB with a shorter loan term of 9 years. This was done to fill a gap in the Council's long-term debt maturity profile for the year 2018/19. This particular loan was secured at a fixed rate of 3.39%.
- 6.3 Long-term gilt yields (on which PWLB interest rates are based) are

currently artificially low due to the Bank of England's quantitative easing operations. Under this scheme, £200bn of gilts, commercial bonds and paper are being purchased which has inflated prices and depressed yields. Once this campaign ends, yields will inevitably rise but will also rise due to the huge level of issuance of new gilts to finance the fiscal deficit. Therefore, some commentators are forecasting that long gilt yields may reach 6% during 2011.

- 6.4 Annex 1 shows that around 75% of the Council's fixed-rate debt is at rates below 4.99%. This may prove to be a good legacy on an historic basis with the prospect of higher inflation and yields from 2011 onwards.
- 6.5 In the short term, there is a possibility that long-term PWLB rates may fall from current levels to near 4% during 2010 due to weak economic recovery and minimal inflation so that the real rate of return (net of inflation) on long gilts is nonetheless attractive at these low levels.
- 6.6 The strategy will be to take out long-term fixed-rate borrowing from the PWLB of up to £17m in the period to March 2011 at a target rate of 4.5% or less, or prevailing rates if this target rate were to prove unattainable.
- 6.7 If fixed-rate long-term borrowing rates were to either fall still further or clear signs of a rising trend in rates was to occur, consideration would also be given to taking out further advances to move to the target fixed/variable rate ratio of 50%/50% more quickly than over a three-year time horizon.

## **7 Policy on borrowing in advance of need**

- 7.1 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.
- 7.2 In determining whether borrowing will be undertaken in advance of need, the Council will:
- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need;
  - ensure the ongoing revenue liabilities created, and the implications for future plans and budgets have been considered;
  - evaluate the economic and market factors that might influence the manner and timing of any decision to borrow.

**8 Debt restructuring**

- 8.1 Local authorities may choose to repay loans earlier than required by the original agreement. In those circumstances, they may be liable either to pay a premium or to receive a discount. A premium is an extra payment required on top of the principal repayment. A discount is a reduction in the principal repayment. Whether a premium or discount applies, and its amount, depends upon the relationship between current interest rates at the time of repayment and the interest being charged on the loan.
- 8.2 Whilst premiums have to be charged to the revenue account, local authorities are allowed to spread these charges for council tax setting purposes over either the outstanding period of the loan repaid or (where applicable) the outstanding period of any replacement loan, whichever is the greater.
- 8.3 Discounts should be treated in a broadly similar way to premiums and credited to the revenue account over either the unexpired term of the repaid loan or 10 years, whichever is the lesser.
- 8.4 The Council's ability to restructure its debt by repaying loans taken out at relatively high interest rates, replacing these with later maturity dates at significantly lower interest rates and spreading the premiums over this extended maturity term can achieve savings in the annual budget requirement for Council Tax setting purposes in the short term.
- 8.5 However, such debt restructuring increases the annual budget requirement for Council Tax setting purposes in the longer term to the extent of the amortised premiums being incurred beyond the original outstanding periods of the loans being repaid.
- 8.6 Such a strategy also increases the average maturity profile of the Council's outstanding debt portfolio, which would impact on its longer term ability to take advantage of low or falling short and long-term interest rates.
- 8.7 In 2007/08, the Council prematurely repaid a £10m PWLB loan at 9.875% which was originally due for repayment in 2018, incurring a premium of £3.9m. Replacement loans of £10m in total were taken out at an average interest rate of 4.74% maturing between 2035 and 2037. This was done in order to achieve savings in the annual budget requirement for Council Tax setting purposes in the short term.

- 8.8 From 1 November 2007, the PWLB introduced a separate set of rates applicable to early repayments. Hitherto, the same set of rates had applied to loan advances and to calculating the premium or discount due on an early repayment. The rates used to calculate the premium/discount due on the early repayment of a loan are now lower than those applying to advances. This has had the effect of increasing the premiums payable in respect of the early repayment of loans.
- 8.9 The Debt Management Office/PWLB have issued a consultation document with suggested options to revise the methodology used to calculate the early repayment rate. The consultation period ended in January 2010 and this Authority will monitor developments in this area and see whether any significant changes are introduced.
- 8.10 It is proposed that the County Treasurer be given the authority to continue to apply such a debt restructuring strategy where there would seem to be financial advantage in doing so, whilst paying due regard to the need to maintain the Council's ability to continue to take full advantage of falling interest rates by avoiding a heavily skewed maturity profile.

## 9 Treasury management budget for 2010/11 to 2012/13

- 9.1 Table 5 summarises the interest budget to finance the Council's capital financing requirement for 2010/11 to 2012/13, inclusive of interest recovered from other external bodies in respect of transferred debt.

**Table 5: Interest budgets for 2010/11 to 2012/13**

	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
Interest on:			
Public Works Loan Board loans	14.8	14.5	14.7
LOBOs	3.3	3.3	3.3
Street Lighting PFI	0.6	2.3	4.9
Temporary loans and internal funds	1.3	2.7	0.6
<b>Total</b>	<b>20.0</b>	<b>22.8</b>	<b>23.5</b>

**10 Prudential indicators for affordability**

10.1 The Prudential Code prescribes two indicators of the affordability of borrowing for capital purposes.

**Ratio of financing costs to net revenue stream**

10.2 The ratio of financing costs to the net revenue stream shows the estimated annual revenue costs of borrowing (interest payable on debt plus the minimum revenue provision for repaying the principal less interest on balances) as a percentage of the amount in the draft revenue budget to be met from central government grants and local taxpayers. Actual figures for 2008/09 and estimates for 2009/10 to 2012/13 are set out in the Table 6 below. It excludes past capital expenditure being financed by external bodies following the transfer of services away from the County Council. The relative stability of the ratio reflects the County Council's decision under the current grant floor arrangements not to take up supported borrowing in full.

**Table 6: Ratio of financing costs to net revenue stream**

	<b>2008/09</b>	<b>2009/10</b>	<b>2010/11</b>	<b>2011/12</b>	<b>2012/13</b>
	<b>Actual</b>	<b>Estimate</b>	<b>Estimate</b>	<b>Estimate</b>	<b>Estimate</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Financing costs	29.1	40.6	49.4	53.7	50.9
Net revenue stream	642.7	657.0	672.1	680.0	688.9
Ratio	4.53%	6.18%	7.35%	7.90%	7.39%

**Estimated incremental impact on council tax of draft capital programme**

10.3 Table 7 sets out estimates of the incremental impact on the Band D council tax which will result if the Cabinet approves the new draft capital programme.

**Table 7: Incremental impact on council tax**

	<b>2010/11</b>	<b>2011/12</b>	<b>2012/13</b>
	<b>£</b>	<b>£</b>	<b>£</b>
Borrowing costs	1.83	7.35	2.57
Running expenses and revenue contributions to capital	2.21	1.63	1.77
<b>Total</b>	<b>4.04</b>	<b>8.98</b>	<b>4.34</b>

10.4 This indicator has been calculated as if the impact of financing new capital investment by borrowing falls entirely on the council tax. However, in practice the cost of financing additional Government supported borrowing is normally matched by additional revenue support grant, although this does not currently apply to authorities such as Hampshire who are well below the grant floor. The new prudential borrowing proposed will be matched by an equivalent reduction in current expenditure within the relevant service or will be covered from future capital receipts, grants or contributions.

**11 Treasury management indicators for external debt**

**Medium term borrowing not to exceed capital financing requirement**

11.1 The Prudential Code requires that, as a key indicator of prudence, net borrowing over the medium term should not exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two years. The County Treasurer will ensure that this limit is not breached.

**Actual external debt**

11.2 Actual external debt at 31 March 2009 was £450.2m.

**Authorised limits for external debt**

11.3 The Code also requires authorities to set authorised limits for external debt, defined as the sum of external borrowing and other long-term liabilities. It is recommended that the following limits be approved for the period 2010/11 to 2012/13.

<b>2010/11</b>	<b>2011/12</b>	<b>2012/13</b>
<b>£m</b>	<b>£m</b>	<b>£m</b>
690	680	680

11.4 These recommended limits are based on the estimated capital financing requirements (as per Table 3) in order to enable these to be financed entirely from external borrowing should the Council's internal reserves become depleted. The limits also include an allowance for temporary borrowing to cover normal revenue cash flow requirements and unexpected outflows or delays in receiving cash. The 2010/11 limit is also the statutory limit for the purposes of Section 3(1) of the Local Government Act 2003. It should be borne in mind that the limits for 2011/12 and 2012/13 are indicative only and can be revised next year if necessary.

### Operational boundaries for external debt

- 11.5 The Cabinet also needs to approve operational boundaries for external debt over the same periods. These should reflect the most likely scenario and be consistent with the Council's capital plans and treasury management strategy. Temporary breaches of the 2010/11 operational boundary can take place for cash flow reasons, but any sustained breach will lead to further investigation. The Cabinet is asked to recommend the following operational boundaries for 2010/11, 2011/12 and 2012/13.

2010/11 £m	2011/12 £m	2012/13 £m
570	560	560

- 11.6 The operational boundary for 2010/11 allows for new external borrowing of £17m, based on the guideline figures for new external long-term borrowing as outlined in paragraph 3.3. The indicative boundaries for 2011/12 and 2012/13 reflect the changes in the predicted capital financing requirement in those two years.

### 12 Other treasury management indicators

#### Adoption of the revised CIPFA Code of Practice for Treasury Management in the Public Services (2009)

- 12.1 The Prudential Code requires local authorities to have adopted the CIPFA's *Treasury Management in the Public Services: Code of Practice* (the Treasury Management Code), which includes an annual report on the treasury management strategy and a plan before the start of the year, and an annual report after its close.
- 12.2 In the light of the Icelandic bank situation in 2008, CIPFA has amended the Treasury Management Code which introduces a new requirement for a mid-year review, and a need to ensure that members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and those responsibilities.

#### Upper limits on fixed interest rate exposure

- 12.3 The Council also has to set an upper limit on its fixed interest exposure (which includes the Street Lighting PFI liability). The table below sets out limits recommended for approval. They are expressed in terms of the maximum long-term fixed-rate principal sums which can be outstanding on any day in each year. The limits suggested for 2011/12 and 2012/13 are indicative only and subject to revision next year.

2010/11 £m	2011/12 £m	2012/13 £m
330	350	380

- 12.4 Long-term fixed-rate debt outstanding is currently £276m. This appendix recommends an annual maximum guideline target for new long-term fixed-rate borrowing of £17m over three years. However, the above limits make allowance for fixed-rate borrowing of up to the identified three-year requirement of £50m to March 2013, as it might be prudent to borrow up to these levels early if rates are particularly advantageous or show signs of a prolonged upward trend.

#### **Upper limits on variable interest rate exposure**

- 12.5 The Council also has to set limits on its variable interest rate exposure. The limits recommended for approval are shown in the table below. They are calculated simply as the difference between the recommended authorised borrowing limits and the fixed-rate borrowing outstanding at the end of each year if no further such borrowing is undertaken.

2010/11 £m	2011/12 £m	2012/13 £m
420	390	370

- 12.6 These recommended limits provide full flexibility for the prudent management of the Council's debt portfolio and mean that there will be no need for enforced fixed-rate borrowing at high interest rates as long as total external borrowing remains within the authorised limits.

#### **Upper and lower percentage limits on the maturity structure of long-term fixed-rate borrowing outstanding in 2010/11**

- 12.7 The Code also requires the Council to set upper and lower percentage limits on the maturity structure of its long-term fixed-rate borrowing during 2010/11. The following table shows recommended limits. These have been set in order to allow maximum flexibility in managing the debt portfolio and are consistent with the existing portfolio and the treasury management strategy as outlined earlier.

	Upper limit (%)	Lower limit (%)
Under 12 months	10	0
12 to 24 months	10	0
24 months to 5 years	20	0
5 years to 10 years	30	10

	Upper limit (%)	Lower limit (%)
10 years and beyond	90	70

### **Upper limits on investments with maturities longer than one year**

- 12.8 The Council has not made any investments for periods longer than one year and has no plans to do so. Therefore, an upper limit of nil on such investments is recommended for 2010/11 and the following two years.

### **13 Financial health indicators**

- 13.1 Annex 2 contains a summary of the prudential indicators and treasury management indicators, and a series of additional financial health indicators relating to budget and capital programme management and income collection. These are monitored quarterly as one element of the County Council's budget monitoring.

### **14 Investment of surplus funds – Annual Investment Strategy**

- 14.1 This proposed Annual Investment Strategy has been prepared in accordance with guidance issued under section 15(1)(a) of the Local Government Act 2003.
- 14.2 When investing its surplus funds, the Council's investment priority is to continue to maintain the security of capital and maintain policy flexibility through liquidity of its investments. The Council will aim to achieve the optimum return on its investments commensurate with the proper levels of security and liquidity.
- 14.3 Accordingly, only 'specified investments' will be used in 2010/11. Specified investments are defined in the Government's guidance as offering both high security and liquidity. All such investments should be in sterling and with a maturity of no more than a year. Such short-term investments made with the UK Government or a local authority will automatically count as specified investments. In addition, short-term sterling investments with banks and building societies with high credit ratings will count as specified investments.
- 14.4 Other, or 'non-specified', investments will not be used, given the greater potential risk.
- 14.5 The Council's surplus funds will either be invested in:-
- fixed-term deposits for periods of up to 364 days with local authorities, the Government's Debt Management Office, or banks and building societies rated at least A2 by Moody's (a Government-recognised credit rating agency) that are included on the Council's lending list;

- call deposits with NatWest Bank (rated Aa3); and
- call deposits with managed Aaa-rated money market funds included on the Council’s lending list, which are currently listed as follows:
  - Standard Life Sterling Fund;
  - RBS Global Treasury Sterling Fund
  - JP Morgan Sterling Fund; and
  - Prime Rate Sterling Fund.

14.6 Such ‘call deposits’ may be recalled by the Council at any time. The Council’s cash flow position will be monitored on a daily basis and adjustments made as necessary to the funds placed on call.

14.7 Lending is restricted to certain of the UK clearing banks and the larger UK building societies, with the Council’s current lending list given as follows:

<b>Counterparty</b>	<b>Moody’s long-term rating</b>	<b>Maximum lending term</b>
Lloyds	Aa3	364 days
NatWest	Aa3	364 days
Barclays	Aa3	364 days
HSBC	Aa2	364 days
Nationwide Building Society	Aa3	364 days
Northern Rock	A2	6 months
Leeds Building Society	A2	3 months
Abbey	Aa3	Overnight

Hierarchy of Moody’s long-term ratings:

Aaa	Obligations rated Aaa are judged to be of the highest quality, with the “smallest degree of risk”.
Aa1, Aa2, Aa3	Obligations rated Aa are judged to be of high quality and are subject to very low credit risk, but “their susceptibility to long-term risks appears somewhat greater”.
A1, A2, A3	Obligations rated A are considered upper-medium grade and are subject to low credit risk, but that have elements “present that suggest a susceptibility to impairment over the long term”.

- 14.8 The Council obtains credit rating information from Moody's, which is one of only three Government-recognised credit rating agencies. Credit ratings are reviewed on at least a monthly basis to identify any changes.
- 14.9 The lending list is closely monitored and reviewed by the County Treasurer, taking into account each institution's credit ratings, asset base, market capitalisation, press reports, etc. Institutions will be removed immediately from the list if any doubt is cast on their creditworthiness. The credit rating agencies have been largely discredited by Iceland and their role in the credit crisis. Credit ratings are just one of the various tools used in making a considered assessment of credit risk.
- 14.10 Limits are placed on levels of total deposits made with individual institutions, based on their relative strength as a counterparty. Whilst the Treasury Management and Annual Investment Strategy sets a maximum lending term of 364 days, this will be shortened in respect of those institutions with a higher perceived credit risk.
- 14.11 The Council delegates responsibility for the execution and administration of treasury management investment decisions to the County Treasurer, who will act in accordance with this Treasury Management Strategy.
- 14.12 Changes to the lending list and the limits on investments will be subject to the approval of the County Treasurer and will be reported in the quarterly review of the financial health indicators.
- 14.13 The County Treasurer will continue to manage cash balances on a cautious basis with the emphasis on capital preservation at the expense, where necessary to avoid unjustifiable risks, of additional interest returns.
- 14.14 For information, the Council has never placed deposits with Icelandic banks and has not used any overseas institutions in over two years.
- 14.15 The County Treasurer's treasury management staff operate within detailed parameters set out in an internal code of practice, which takes account of CIPFA's *Treasury Management in the Public Services: Code of Practice* and other guidance issued by the Chartered Institute of Public Finance and Accountancy.
- 14.16 In-house expertise is considered sufficient not to warrant the use of external treasury management advisers.
- 15 Policy on Minimum Revenue Provision to repay debt**
- 15.1 The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 requires that before the start of

each financial year, a local authority prepares a statement of its policy on making Minimum Revenue Provision (MRP) for the approval of the Full Council or equivalent. These revised regulations repealed the detailed rules and replaced them with statutory guidance, while requiring local authorities to make 'prudent' provision for the repayment of debt.

- 15.2 It is recommended that the Council continues with the policy adopted for 2009/10, i.e., to continue to calculate MRP in respect of supported capital expenditure, incurred both before and after 1 April 2008, in accordance with the previous regulations (i.e., generally based on 4% of the Council's outstanding capital financing requirement). In respect of prudential borrowing relating to capital expenditure incurred after 1 April 2008, it is proposed to calculate MRP on the basis of asset life, using the equal instalment basis and adopting asset lives that are no greater than those used to calculate the depreciation provision for the relevant assets.

**PWLB fixed-rate debt as at 31 March 2010 by interest rate**

<b>Interest rate</b>	<b>Principal outstanding</b>
<b>%</b>	<b>£m</b>
3 – 3.99	13
4 – 4.99	194
5 – 5.99	16
6 – 6.99	6
7 – 7.99	10
8 – 8.99	5
9 – 9.99	32
<b>Total</b>	<b>276</b>

**PWLB fixed-rate debt by year of maturity**

<b>Year</b>	<b>Interest rates (range)</b>	<b>Principal repayable</b>
	<b>%</b>	<b>£m</b>
2010/11	3.89 - 4.625	9
2011/12	8.5	5
2012/13	4.2 – 6	4
2013/14	4.25 - 4.625	6
2014/15	9.375	10
2015/16	9.125 – 9.25	7
2016/17	4.4 – 9.875	8
2017/18	9.375 – 9.875	9
2018/19	3.39 – 3.59	4
2019/20	4.625 – 4.875	6
2020/21	4.45 – 4.875	8
2021/22	4.5 – 7.375	8
2022/23	4.5 – 7.5	8
2023/24	4.625 – 7.25	8
2024/25	4.5 – 7.25	10
2025/26	4.5 – 7.125	9
2026/27	4.4 – 6.25	10
2027/28	5 – 5.875	8
2028/29	4.5 – 4.875	8
2029/30	4.5 – 4.95	9
2030/31	4.25 – 4.5	8
2031/32	4.25 – 4.95	14
2032/33	3.97 – 4.85	12

<b>Year</b>	<b>Interest rates (range)</b>	<b>Principal repayable</b>
	<b>%</b>	<b>£m</b>
2033/34	4.09 – 4.75	18
2034/35	4.17 – 4.75	14
2035/36	3.85 – 4.85	22
2036/37	4.1 – 4.7	12
2037/38	4.75 – 5	6
2038/39	4.7	2
2039/40	4.6	2
2041/42	4.43 – 4.49	6
2042/43	4.39 – 4.51	4
2043/44	4.54	2
<b>Total</b>		<b>276</b>

**LOBO debt as at 31 March 2010 by interest rate**

<b>Interest rate</b>	<b>Principal outstanding</b>
<b>%</b>	<b>£m</b>
3 – 3.99	16
4 – 4.99	53
5 – 5.99	4
<b>Total</b>	<b>73</b>

**LOBO debt by year of maturity**

<b>Year</b>	<b>Interest rates (range)</b>	<b>Principal repayable</b>
	<b>%</b>	<b>£m</b>
2027/28	4.99	4
2028/29	4.80	4
2030/31	5.00	4
2034/35	4.75 – 4.95	8
2036/37	3.89 – 3.95	8
2037/38	4.42 – 4.45	9
2040/41	4.77 – 4.85	8
2042/43	3.89 – 3.94	8
2043/44	4.50	4
2045/46	4.25	10
2055/56	4.25	6
<b>Total</b>		<b>73</b>

**A. Summary of prudential indicators, treasury management indicators and other financial health indicators**

		2008/09 Actual	2009/10 Estimate	2010/11 Estimate	2011/12 Estimate	2012/13 Estimate
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**Prudential indicators for capital expenditure**

Capital expenditure	£m	193.6	185.6	210.3	161.0	117.1
Capital financing requirement	£m	624.0	653.5	684.2	673.4	671.3

**Prudential indicators for affordability**

Ratio of financing costs to net revenue stream	%	4.53	6.18	7.35	7.90	7.39
Incremental impact of capital programme on council tax	£	n/a	n/a	4.04	8.98	4.34

**Prudential indicators for prudence**

Medium-term borrowing not to exceed capital financing requirement		County Treasurer will ensure this is not breached				
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**Treasury management indicators for external debt**

Actual external debt	£m	450.2	n/a	n/a	n/a	n/a
Authorised limits	£m	620.0	690.0	690.0	680.0	680.0
Operational boundaries	£m	510.0	570.0	570.0	560.0	560.0

**Other treasury management indicators**

Adoption of revised CIPFA Code of Practice (2009)		Agreed by County Council in February 2010				
Upper limits – fixed rates	£m	268.0	320.0	330.0	350.0	380.0
Upper limits – variable rates	£m	212.0	440.0	420.0	390.0	370.0

**Maturity structure of fixed-rate debt**

**Upper limits**

Under 12 months	%	1	1	10	10	10
12 to 24 months	%	3	3	10	10	10
24 months to 5 years	%	4	6	20	20	20
5 years to 10 years	%	11	14	30	30	30
10 years and beyond	%	81	76	90	90	90

**Lower limits**

Under 12 months	%	1	1	0	0	0
12 to 24 months	%	3	3	0	0	0
24 months to 5 years	%	4	6	0	0	0
5 years to 10 years	%	11	14	10	10	10
10 years and beyond	%	81	76	70	70	70

<b>Total sums invested for more than 364 days</b>	<b>£m</b>	<b>Nil</b>	<b>Nil</b>	<b>Nil</b>	<b>Nil</b>	<b>Nil</b>
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<b>B. Financial health indicators</b>		<b>2008/09 Actual</b>	<b>2009/10 Estimate</b>	<b>2010/11 Estimate</b>	<b>2011/12 Estimate</b>	<b>2012/13 Estimate</b>
<b>Variance from budget</b>						
Net service spending	%	-0.1	-0.3	+/-1	+/-1	+/-1
Overall spending met from formula grant, council tax and balances	%	-0.8	-0.7	+/-2	+/-2	+/-2
Balances as a % of budget requirement	%	5.4	4.5	3.2	2.6	2.7
<b>Capital programme management</b>						
Carry forward of schemes	%	32.0	20.0	20.0	20.0	20.0
Actual capital expenditure compared with estimate	%	-9.1	+/-10.0	+/-10.0	+/-10.0	+/-10.0
Actual capital receipts and third party contributions compared with estimate	%	-12.6	126.8	+/-10.0	+/-10.0	+/-10.0
<b>Income collection</b>						
% of outstanding debt more than 12 months old	%	10.4	17.5	17.5	17.5	17.5
% of outstanding debt more than 6 months old	%	14.6	20.0	20.0	20.0	20.0
% of outstanding debt under 60 days old	%	60.5	60.0	60.0	60.0	60.0
% of debt written off to debt raised	%	0.3	<1.0	<1.0	<1.0	<1.0