Stevenage BOROUGH COUNCIL

PART I

Release to Press

Meeting: **Executive**

Portfolio Area: Resources

Date: **14 February 2007**

THE PRUDENTIAL CODE INDICATORS AND TREASURY MANAGEMENT STRATEGY

Finance

KEY DECISION

Author – C Jewsbury Ext.No. 2351
Contributors – P Shawcroft Ext No 2430, P Coletta Ext No 2933,
Lead Officer – Scott Crudgington Ext.No. 2185
Contact Officer – C Jewsbury Ext.No. 2351

1 PURPOSE

To recommend to Council, the approval of the 2007/08 Prudential Indicators and Treasury Management Strategy.

2 RECOMMENDATIONS

2.1 That the Executive proposes to Council the adoption of the Prudential Code Indicators as detailed in Appendix A.

2.2 That the Executive proposes to Council the adoption of the 2007/08 Treasury Management Strategy as detailed in paragraph 4.2.

3 BACKGROUND

3.1 The Local Government Act 2003 required that from April 2004 Councils must `have regard to' the Prudential Code and set Prudential Indicators to ensure that capital investment plans are affordable, prudent and sustainable. The indicators cover the current year and the next 3 years.

3.2 The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy; which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

3.3 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that arise as a result of capital financing decisions. This therefore means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

3.4 The legislation abolished Credit Approvals, which had previously controlled Council borrowing, in favour of a system in which Affordable Borrowing Limits are determined with regard to the code of practice published by CIPFA `The Prudential Code for Capital Finance in Local Authorities'.

3.5 In July 2006 the Council submitted a Round 6 Arms Length Management Organisation (ALMO) Bid to the Department for Communities and Local Government (DCLG) for some £50million of funding, in the form of ALMO Borrowing, to assist in achieving the Decent Homes target in the Council's HRA Housing Stock. At the time of writing the outcome of the Council's bid is still unknown. The ALMO Borrowing approval will allow the Council to borrow funds to undertake the Decent Homes works, with the interest charges on the borrowing being funded through the HRA Subsidy System. Access to the ALMO borrowing is also dependant upon Stevenage Homes Limited (SHL) achieving at least a 2 Star rating in their inspection scheduled for November 2007.

3.6 The Council does not anticipate undertaking any long term borrowing during 2007/08 for non-HRA purposes. Therefore given the timing restrictions on the access to the ALMO Borrowing it seems inappropriate to set the Prudential Indicators and Borrowing Limits for 2007/08, at this stage, in anticipation of the ALMO Borrowing. The Indicators in this report do not therefore, at this stage, take into account the potential ALMO borrowing that may occur late in 2007/08 and it is proposed that a major review of the indicators, investment and borrowing strategy will be undertaken later in the year and brought back for updated approval closer to the timing of accessing the ALMO Borrowing following achieving the 2 star ALMO rating.

4 REASONS FOR RECOMMENDED COURSE OF ACTION AND OTHER OPTIONS

4.1 **Prudential Code**

4.1.1 A schedule of Prudential Code Indicators with explanatory notes is attached at Appendix A. Those indicators to which regard should be given when determining the Council's treasury management strategy for the next 3 financial years are denoted by an asterix(*****).

4.1.2 The Prudential Code introduced new requirements for the manner in which capital spending plans are to be considered and approved and in conjunction with this, the development of an integrated treasury management strategy. Appendix B details the objectives of the Prudential Code.

4.2 Treasury Management Strategy

4.2.1 <u>Borrowing Strategy</u>

4.1.1 4.2.1.1 Various borrowing limits have to be approved before the start of each financial year.

4.2.1.2 As the Council has had debt free status since March 2001, only short term borrowing for cash flow management purposes is currently undertaken and, therefore, the overall and short term limits are identical. In addition, the variable interest proportion is set at 100% - short-term borrowing is likely to be minimal but could consist of only one loan - at variable or fixed rate depending on the availability of funds in the money market.

4.2.1.3 The limits proposed for 2007/08 (unchanged from 2006/07) are:-

Overall Borrowing Limit - £15million
Short Term Borrowing Limit - £15 million
Variable Interest Proportion Limit - 100%

4.2.1.4 As stated above at paragraphs 3.5 and 3.6, the Council does not anticipate undertaking any long term borrowing during 2007/08 for non-HRA purposes. The Indicators in this report do not, at this stage, take into account the potential ALMO borrowing that may occur late in 2007/08 and it is proposed that a major review of the investment and borrowing strategy will be undertaken later in the year and brought back for updated approval closer to the timing of accessing the ALMO Borrowing following achieving the 2 star ALMO rating.

4.2.2 Prospect for Interest Rates

4.2.2.1 The base rate at the start of the financial year was 4.50% rising to 4.75% in August, with further increases of 0.25% in both November and January, making the current rate 5.25%. At present, there are conflicting views as to future trends. Current investment rates are as below.

One month	**5.35%**
Three months	**5.48%**
Six months	**5.61%**
One Year	**5.77%**

The Council has budgeted for an average return on investments for 2007/08 of 4.75%.

4.2.3 Investment Strategy

4.2.3.1 The Council is required to prepare an Annual Investment Strategy, which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

4.2.3.2 In May 1999, £20m was placed with an external fund manager. Due to the underperformance of the external fund manager, during the course of 2006/07 £12.5m was withdrawn from the fund and its investment is now undertaken in-house. At 31 December 2006, the external fund value including reinvested interest was £15.51m. The average interest rate to date this year is 4.00%. The Fund Manager is forecasting a return on the investment of 5.5% for 2007/08.

4.2.3.3 Officers are continuing to keep the external fund manager's performance under review. As previously requested by the Executive, a separate report will be brought forward outlining the various investment options available to the Council in relation to the £15.51 million currently with the external fund manager. These options will include closing the fund, transferring further funds to be internally managed, tendering for a new fund manager or a combination of these options. A meeting has been arranged with the external fund manager and our treasury management advisors to review 2006/07 performance and the assumptions supporting their forecasts for 2007/08. The result of this meeting will be included in the further report to Members.

4.2.3.4 The balance of the investments are managed in-house. With the exception of the money brought in-house from the external fund manager, the principal consideration when undertaking an investment in-house is the Council's cash flow requirements, ie investments are scheduled to mature on a date when it is known large cash flows will occur. When surplus cash becomes available for investment, it is used to maintain a balanced investment portfolio. As at the end December 2006 the total of in house investments was £33.45m. Average return to date this year being 4.86%.

4.2.3.5 The total fund; that is external and internal at the end of December was £48.96m, giving an average return of 4.60% this year to date.

4.2.3.6 A list of banks and building societies, which currently meet our credit worthiness, is attached at Appendix C. A list of the types of instruments comprising Specified and Non-Specified Investments is attached at Appendix D.

4.2.4 Summary – Treasury Management Strategy

a) That the Prudential Indicators are adopted and kept under review.

b) That surplus funds are invested according to Treasury Policy.

c) That the use of the external fund manager is kept under review

d) That a review will be undertaken in advance of the anticipated ALMO borrowing.

5 IMPLICATIONS

5.1 Financial Implications

The report is of a financial nature and outlines the Prudential Code Indicators and the principals under which the Treasury Management functions are managed.

5.2 Legal Implications

Approval of the Prudential Code Indicators and the Treasury Management are intended to ensure that the Council complies with relevant legislation and best practice.

5.3 Policy Implications

The proposed limits are in line with current policy.

BACKGROUND DOCUMENTS

- Statutory Instrument 2003 No 3146 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003
- CIPFA Prudential Code for Capital Finance in Local Authorities
- Sector Treasury Management Documents

APPENDICES

- Appendix A - Prudential Code Indicators
- Appendix B – Prudential Code Objectives
- Appendix C - Lending List
- Appendix D - Specified and Non-Specified Investments

APPENDIX A

PRUDENTIAL CODE INDICATORS

1. The actual capital expenditure that was incurred in 2005/06 and the estimates of capital expenditure for the current and future years that are recommended for approval are:

	2005/06 Actual £000's	2006/07 Probable £000's	2007/08 Estimate £000's	2008/09 Estimate £000's	2009/10 Estimate £000's
General Fund	10,603	27,388	7,451	8,052	6,433
HRA	8,880	11,342	10,756	6,985	7,085
Total	19,483	38,730	18,207	15,037	13,518

2. Estimates of the ratio of financing costs to net revenue stream for the current and future years, and the actual figures for 2005/06 are:-

	2005/06 Actual %	2006/07 Probable %	2007/08 Estimate %	2008/09 Estimate %	2009/10 Estimate %
Financing Costs re. General Fund Capital Exp	10.48	11.58	14.65	18.32	20.16
HRA Capital Exp	1.62	4.09	4.95	5.60	5.66

3. Estimated capital financing requirements for the current and future years and the actual capital financing requirement at 31st March 2006 are:

31/03/06 Actual £000's	31/03/07 Probable £000's	31/03/08 Estimate £000's	31/03/09 Estimate £000's	31/3/10 Estimate £000's
-4,593	-5,000	-5,000	-5,000	-5,000

4. The estimated incremental impact of capital expenditure proposals on Band D Council Tax is as follows:

2006/07 £	2007/08 £	2008/09 £
22	24	24

PRUDENTIAL CODE INDICATORS

5. In order to ensure that over the medium term net borrowing will only be for capital purposes, net external borrowing should not exceed the total of capital financing requirements in the preceding year plus estimated current and next 2 years requirement.

6. * Authorised limit for external debt:

	2005/06 £000's	2006/07 £000's	2007/08 £000's	2008/09 £000's	2009/10 £000's
Borrowing	15,000	15,000	15,000	15,000	15,000
Other Long Term Liabilities	Nil	Nil	Nil	Nil	Nil

7. * The Code also requires an Operational Limit to be set which can be less than the Authorised Limit. However, in this Council's circumstances it is recommended that the Operation Limit equates to the Authorised Limit.

8. ***** The Council has adopted the CIPFA Code of Practice for Treasury Management and manages its treasury position in terms of borrowings and investments in accordance with the code.

9. ***** Upper limit of variable interest rate exposure as a percentage of total debt:

2005/06	2006/07	2007/08	2008/09	2009/10
100%	100%	100%	100%	100%

10. * Short term borrowing limit:

2005/06 £000's	2006/07 £000's	2007/08 £000's	2008/09 £000's	2009/10 £000's
15,000	15,000	15,000	15,000	15,000

PRUDENTIAL CODE INDICATORS

11. * Interest Rate Exposure

Fixed Interest Rate This is defined as the maximum principal sums outstanding at fixed rates, less the principal sums outstanding in respect of investments that are fixed rate investments. As the Council is debt free, this is a negative figure. As an external fund manager is employed, it is felt that more meaningful figures are obtained if the internal and external funds are shown separately.

	2005/06 £000's	2006/07 £000's	2007/08 £000's	2008/09 £000's	2009/10 £000's
SBC	-27,000	-40,000	-44,000	-46,000	-48,000
Fund Manager	-31,000	-31,000	-22,500	-24,000	-25,000

Variable Interest Rate This is defined as above, but substituting 'variable rates' for 'fixed rates'

	2005/06 £000's	2006/07 £000's	2007/08 £000's	2008/09 £000's	2009/10 £000's
SBC	-10,000	-10,000	-10,000	-10,000	-10,000
Fund Manager	-31,000	-31,000	-22,500	-24,000	-25,000

12. * Maturity Structure of Borrowing

As the Council is debt free, this indicator does not apply.

13 * Total principal sums invested for periods longer than 364 days.

	2005/06 £000's	2006/07 £000's	2007/08 £000's	2008/09 £000's	2009/10 £000's
SBC	12,000	20,000	22,000	22,000	22,000
Fund Manager	29,000	31,000	22,500	24,000	25,000

* denotes indicators which form part of the Treasury Management Strategy

APPENDIX B

PRUDENTIAL CODE OBJECTIVES

1 The key objectives of the Prudential Code are:-

1.1

- To ensure that capital investment plans are affordable, prudent and sustainable.
- To ensure treasury management decisions accord with good professional practice and in a manner that supports affordability, prudence and sustainability.
- To be consistent with and support local strategic planning, local asset management planning and option appraisal.

1.2 To demonstrate the achievement of these objectives the Prudential Code sets out indicators that must be used and the factors that must be taken into account. The code does not suggest limits or ratios as these are for the authority to determine.

The regulations do not cover Investments other than to require authorities to have regard to the CIPFA Treasury Management Code.

1.3 The prudential indicators are designed to support and record local decision making. They are not intended to be comparative performance indicators and their use in this way could be misleading. In particular, authorities will have widely different debt positions at the start of the Prudential system and the exercise of local choice could increase these differences.

1.4 The Act refers to affordability only, whereas the Code refers to affordability and prudence. The two are related concepts. When making a decision to invest in capital assets an authority must not only determine whether it can afford the immediate cost. To ensure long-term affordability the decisions have also to be prudent and in the long term sustainable. Therefore in carrying out their duties in respect of affordability an authority is required to have regard to all the aspects of the Code that relate to affordability, sustainability and prudence. The code also requires an authority to have regard to wider management processes (option appraisal, asset management planning, strategic planning and achievability) in accordance with good professional practice.

1.5 The Code promotes transparency by using information in the published statements of accounts.

1.6 The authority should have a treasury management strategy within which borrowing and investments are managed in accordance with good professional practice.

2 Governance

2.1 The Code sets out the procedure for setting and revising prudential indicators. The body that decides the authority's budget ie Council will do this. The Chief Financial Officer is responsible for reporting and monitoring.

2.2 Indicators for previous years will be taken directly from information in the statement of accounts. If any relevant item is subject to audit qualification this must be highlighted when the indicators are set/revised.

2.3 Indicators for the forthcoming and following years must be set before the beginning of the forthcoming year. They may be revised at any time, following due process, and must be reviewed for the current year when the prudential indicators are set for the following year.

2.4 Prudential indicators for treasury management should be considered along with the treasury management strategy.

3 Affordability

3.1 The objective here is to ensure that total capital investment remains within sustainable limits and, in particular, to consider the impact on Council Tax.

3.2 In considering the affordability of its capital plans, the authority is required to consider all of the resources available, together with the totality of its capital plans, revenue income and expenditure forecasts for the forthcoming year and the following two years, plus known significant variations beyond this timeframe. This necessitates as a minimum three-year capital, revenue and Council Tax forecasts. We forecast on a five year timeframe.

3.3 Affordability considerations should include risk and uncertainty, and risk analysis and risk management strategies should be taken into account.
The affordability indicators include:-

- capital expenditure
- the ratio of financing costs to net revenue stream.
- capital financing requirements (need to borrow)
- the incremental impact of capital investment decisions on the Council Tax
- the authorised limit for external debt
- the operational limit for external debt
- actual external debt

3.4 Both the authorised and operational limits for external debt need to be consistent with the plans for capital expenditure and accounting, and with the treasury management policy and practices. The operational limit should be based on a prudent but not worst case scenario, whilst the authorised limit can include headroom over and above the authorised limit, sufficient for example for unusual cash flow movements.

4 Prudence and Sustainability

4.1 As noted earlier, prudential indicators in respect of external debt must take account of affordability. Through this means the objectives of prudence and sustainability are addressed year on year.

4.2 To ensure that over the medium term net borrowing is only for capital purposes, an authority must ensure that, except in the short term, net external borrowing does not exceed the total capital financing requirements of the previous year's actual plus current and next 2 years estimates.

4.3 Prudence also includes that treasury management is carried out in accordance with good professional practice. The relevant indicators are:-

- Net external borrowing not to exceed the preceding years capital financing requirement plus current and next year's estimated capital financing requirement

- compliance with the CIPFA Code of Practice for Treasury Management

- upper limits on fixed interest rate and variable interest rate exposures

- upper and lower limits for the maturity structure of borrowings

- upper limit for principal sums invested for longer than 364 days