

Meeting: COUNCIL

Agenda Item:

Portfolio Area: Resources

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Date: 27 February 2008

THE PRUDENTIAL CODE INDICATORS AND TREASURY MANAGEMENT STRATEGY

(Finance)

KEY DECISION

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1 PURPOSE

To recommend to Council, the approval of the 2008/09 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 2008/09 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 Council has adopted the CIPFA Code of Practice on Treasury Management. These were adopted on 18 May 2004 by the full Council. 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. In December 2007 the Council received notification from DCLG that it had been awarded a place on the Round 6 ALMO Programme. 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 Audit Commission Inspection.
- 3.6 The Council does not anticipate undertaking any long term borrowing during 2008/09 for non-HRA purposes. The Indicators in this report do not therefore, at this stage, take into account the potential ALMO borrowing that may occur in early 2009/10 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 Borrowing Strategy

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 2008/09 (unchanged from 2007/08) 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 2008/09 for non-HRA purposes. The Indicators in this report do not, at this stage, take into account the potential ALMO borrowing that may occur in 2009/10 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 2007/08 financial year was 5.25% rising to 5.50% in May '07, with a further increase of 0.25% in July '07. The Base Rate stayed at 5.75% until December when it was cut to 5.50%. At present, there is a fairly general consensus that there will be further rate cuts. It is anticipated that the Base Rate will reduce to 5% over the course of 2008/9 and then remain unchanged for up to two years. Current investment rates are as below.

One month	5.55%
Three months	5.57%
Six months	5.50%
One Year	5.20%

The Council has budgeted for an average return on investments for 2008/09 of 5.25%.

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. Upon receipt of previous annual treasury management reports members have challenged the apparent underperformance of the external fund manager and, during the course of 2006/07 £12.5m was withdrawn from the fund. Since then, their performance has declined to such an extent that in the last quarter of 2007, the remaining funds were withdrawn. The average return during 2007/08 on the fund, to date of closure was 5.54%.

4.2.3.3 All investment is now undertaken in-house. At the time approval was obtained to close the fund manager account, the investment limit was raised to £7.5m per institution. This being the combination of limits previously split between in-house and external funds.

4.2.3.4 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 2007 the total of in house investments was £41.09m. Average return to date this year being 5.73%. The current maturity profile of the funds is detailed below.

Financial Year	Amount £'000
Before 31/3/08	23,890
During 2008/09	5,200
2009/10	5,000
2010/11	7,000

Funds due to mature in 2010/11 are Callable deposits and likely to be repaid before maturity.

4.2.3.5 The Council uses the Sector creditworthiness service. This provides a comprehensive monthly updated list based on Fitch and Moody ratings, (the standard market rating agencies) plus updates as they occur. If a downgrade results in a bank or building society no longer meeting the Council's minimum criteria, it will not be used for new investments.

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 a review will be undertaken in advance of any 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