DECISION

RIBBLE VALLEY BOROUGH COUNCIL
REPORT TO POLICY & FINANCE COMMITTEE

Agenda Item No 13

meeting date: 23 MARCH 2010
title: TREASURY MANAGEMENT STRATEGY
submitted by: DIRECTOR OF RESOURCES
principal author: TRUDY HOLDERNESS

1 PURPOSE

1.1 To approve the Council's Treasury Management strategy for 2010/11

2 BACKGROUND

2.1 The Prudential Code for Capital Finance in Local Authorities (the Code) initially came into effect from 1 April 2004. It has recently been revised to take account of the implication of the implementation of International Financial Reporting Standard (IFRS).

2.2 The prudential framework, allows the Council to be more flexible in its approach to capital investment decisions.

2.3 The importance of treasury management has increased as a result of the freedoms provided by this prudential code. It covers the borrowing and investment activities and the effective management of associated risks. Its activities are strictly regulated by statutory requirements and a professional code of practice (CIPFA Code of Practice on Treasury Management).

2.4 A revised Treasury Management Code of Practice has recently been issued following the House of Commons Select Committee and Audit Commissions investigations into the collapse of the Icelandic banks

2.5 The main changes included in the code are: -

- ❖ Minimum reporting requirement – the original code required two reports each year, one prior to the start of the financial year which sets out the strategy and one after the close of the financial year reporting operational activity. The revised code requires that in addition to these two reports, as a minimum, a mid year report is also presented. Currently 4 monitoring reports are produced in the year.
- ❖ Scrutiny – the Authorities strategy should identify the body responsible for the scrutiny of the treasury management.
- ❖ Training for those charged with governance – The Director of Resources must ensure that appropriate training is available in order for those responsible for treasury management can effectively discharge their duties. This includes those charged with governance and officers.
- ❖ Approval – Full Council should approve the treasury management strategy. This committee approves the strategy and is then formally approved by Full Council.

2.6 The two codes are effective for the financial year commencing 1 April 2010. This means that the treasury management strategy for 2010/11 will need to reflect the new requirements. However whilst the revised Prudential Code is effective from 1 April 2010, until balance sheets are restated for IFRS the definitions in the original definitions may still need to be used. Once the 2009/10 balance sheet has been restated for IFRS the 2009/10 Prudential Indicators will need to be calculated using the definitions in the revised code.

2.7 The new code, along with the existing code already adopted by the Council, require the authority to produce an annual treasury management strategy. The strategy covers the operation of the treasury function and its likely activities for the forthcoming year, including a number of prudential indicators.

2.8 A key requirement of this report is to explain both the risks and the management of the risks associated with the treasury service.

2.9 The attached strategy covers:

- The current treasury position
- A review of the prospects for interest rates
- The Council's borrowing and debt strategy
- The Council's investment strategy
- Capital programme financing strategy
- Limits on treasury management activities and prudential indicators
- Current debt portfolio position
- Annual investment strategy

2.10 The Treasury management strategy

3 RECOMMENDED THAT COMMITTEE

3.1 Recommend to Council the Treasury Management Strategy as set out in the report.

SENIOR ACCOUNTANT

PF18-10/TH/AC
10 MARCH 2009

MARCH 2010

RIBBLE VALLEY

BOROUGH COUNCIL

TREASURY MANAGEMENT STRATEGY 2010/11

Key Officer Contacts for Treasury Management Strategy

Name	Job Title	Telephone Number	Email address
Jane Pearson	Director of Resources	01200 414430	Jane.pearson@ribblevalley.gov.uk
Lawson Oddie	Financial Services Manager	01200 414541	Lawson.oddie@ribblevalley.gov.uk
Trudy Holderness	Senior Accountant	01200 414436	Trudy.holderness@ribblevalley.gov.uk

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1 CURRENT TREASURY POSITION

1.1 The Council's detailed treasury position is highlighted below; a more detailed report on the Councils treasury management activity for 2009/10 will be submitted to this committee by September.

	31.03.09 Actual £m	Average Actual Rate %	31.03.10 Estimate £m	Average Estimated Rate %
Fixed Rate Debt	6.9	5.3	0.6	5.7
Temporary Investments	3.4	5.8	1.3	5.7
Net Borrowing	**3.5**		**-0.7**	

1.2 The Councils current treasury position, and any expected changes to that position, are at risk from any adverse movement in interest rates.

2 A REVIEW OF THE PROSPECTS FOR INTEREST RATES

2.1 The Monetary Policy Committee (MPC) of the bank of England takes interest rate decisions. It is the banks core purpose to maintain the integrity and value of the currency. It pursues this core purpose primarily through the conduct of monetary policy and by setting short term interest rates the bank aims to meet the Government inflation targets.

2.2 The MPC can do little to alter the near term path of inflation. Its task is to set policy so that the inflation outlook is close to its target.

2.3 The government has set the bank's MPC a target for annual inflation rate of the consumer price index (CPI) of 2%.

2.4 A gradual recovery in GDP growth is in prospect, boosted by monetary policy, and supported by global growth and the past depreciation of sterling. A number of factors will weigh on the strength of the recovery, including the continuing restructuring of banks' balance sheets and the drag from fiscal tightening. Despite the pickup in growth, output is likely to remain below the level it would have reached had it continued along its pre-recession trend

2.5 The outlook for CPI inflation is likely to remain elevated in the near term. CPI actually rose to 2.9% in December, from just 1.1% three months earlier. Higher VAT, higher petrol price inflation and the continuing adjustment of prices to the past depreciation of the exchange rate largely accounted for the increase. As these effects dissipate, inflation is likely to fall back to below target,

2.6 The CPI inflation projections in the MPC February inflation report based on the interest rate at 0.50% and £200 billion asset purchases were as follows:

	Annual Inflation
2010Q1	3.42
2010Q2	2.89
2010Q3	2.08
2010Q4	1.72
2011Q1	1.08
2011Q2	1.24
2011Q3	1.50
2011Q4	1.81
2012Q1	2.16

2.6 This shows that the immediate prospect for CPI inflation is to remain well above the 2% target, and output to recover slowly. The downward pressure from the persistent margin of spare capacity in the economy was likely to cause inflation to fall back to below the target for a period, before gradually returning to around the target as the recovery proceeded. In light of that outlook and in order to keep inflation on track to meet the 2% target over the medium term, the MPC judged that it was appropriate to maintain bank base rate at 0.5% and its stock of purchased assets financed by the issuance of central bank reserves at £200 billion.

2.7 In the period leading up to the MPC's February decision, the path implied by forward market interest rates was for Bank Rate to remain close to 0.5% until 2010 Q3. Bank Rate was assumed to rise thereafter, over the remainder of the forecast period. The expected movement in interest rates is shown below:

	Base Rates %
2010Q1	0.50
2010Q2	0.50
2010Q3	0.60
2010Q4	1.00
2011Q1	1.30
2011Q2	1.70
2011Q3	2.10
2011Q4	2.50
2012Q1	2.80
2012Q2	3.10
2012Q3	3.30
2012Q4	3.50
2013Q1	3.60

2.8 Public Works Loan Board interest rates show a similar pattern.

	Fixed Rate %
1 –2 years	0.98
5 - 6 Years	2.10
20 - 25Years	4.49

2.9 Projection is therefore interest rates to remain below 1% for the next financial year.

3 BORROWING AND DEBT STRATEGY 2010/11 – 2012/13

3.1 The introduction of the Prudential Code and uncertainty over future interest rates increases the risks associated with the treasury strategy. As a result the Council needs to take a cautious approach to its treasury strategy.

3.2 Long term fixed interest rates and base rates are both expected to remain very volatile in the short term and difficult to predict. Taking into account the interest rates shown in the table above, the most appropriate form of borrowing will be undertaken.

3.3 We intend to continue the current policy of meeting our long term borrowing requirements from the Public Works Loan Board.

3.4 We will engage in short-term borrowing from the money market if necessary in order to finance temporary cash deficits, however by managing our cash flow effectively these will be kept to a minimum. Wherever possible, the loan will be taken out for periods of less than 7 days in order to minimise the interest payable.

4 INVESTMENT STRATEGY 2010/11 - 2012/13

4.1 Expectations on shorter-term interest rates, on which investment decisions are based, shows a likelihood that rates will remain at their current low levels, but again may change sharply as government action to deal with the economy changes. The most appropriate form of investments will be undertaken depending on the prevailing interest rates at the time, taking into account any associated rate risks.

4.2 All investments will be made in accordance with the Council's investment policies and prevailing legislation and regulations.

5 CAPITAL PROGRAMME FINANCING STRATEGY

5.1 It is intended that the Council finance its capital programme in the following ways:

- By use of prudential borrowing
- From usable capital receipts
- From external contributions
- From grants
- From revenue or reserves

6 LIMITS ON TREASURY MANAGEMENT ACTIVITIES AND PRUDENTIAL INDICATORS 2010/11-2012/13

6.1 The Local Government Act 2003 required the Council to have regard to the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

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6.2 A key indicator of prudence is to ensure that over the medium term net borrowing will only be for a capital purpose and that net external borrowing does not except in the short term, exceed the total capital financing requirement in the preceding year plus the estimates of any additional capital financing requirements for the current and the next two financial years. These indicators, which were approved as part of the annual budget on 2 March, are as follows:

6.3 The capital financing requirement for the authority for the current and future years is:

	CAPITAL FINANCING REQUIREMENT				
	31.03.09 Actual	**31.03.10 Revised Estimate**	**31.03.11 Estimate**	**31.03.12 Estimate**	**31.03.13 Estimate**
Total General Fund	3,324	3,710	3,927	3,885	3,841

6.4 The authorised limits for our total external debt, gross of investments for the next three financial years is:

AUTHORISED LIMIT FOR EXTERNAL DEBT			
	2010/11 £000	**2011/12 £000**	**2012/13 £000**
Borrowing	11,231	11,255	11,255
Other Long-Term Liabilities	0	0	0
Total	**11,231**	**11,255**	**11,255**

6.5 These limits have been estimated taking into account the authorities current commitments, existing plans and proposals for capital expenditure and financing with sufficient headroom to allow for operational management, for example unusual cash movements.

6.6 In addition to the authorised limits for external debt an operational boundary for external debt was approved as part of the annual budget. The proposed operational boundary is based on the same estimates as the authorised limits but without the additional headroom.

6.7 The operational boundary for our external debt for the next three years is:

OPERATIONAL BOUNDARY FOR EXTERNAL DEBT			
	2010/11 £000	**2011/12 £000**	**2012/13 £000**
Borrowing	6,589	6,553	6,467
Other Long-Term Liabilities	0	0	0
Total	**6,589**	**6,553**	**6,467**

6.8 The operational boundary is key management tool used in the prudential indicators.

6.9 The aim of the prudential indicators is to contain the activity of the treasury function within certain limits thereby reducing the risk or likelihood of an adverse movement in interest rates or borrowing decisions that could impact negatively on the Council's overall financial position.

6.10 The introduction of the prudential code saw the replacement of limits previously imposed with four new prudential indicators.

- ❖ Upper limits on variable rate exposure. This indicator identifies a maximum limit for variable interest rates based upon the debt provision net of investments.
- ❖ Upper limits on fixed rate exposure. Similar to the previous indicators, this covers a maximum limit on fixed interest rates
- ❖ Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing.
- ❖ Total principal funds invested for a period longer than 364 days. These limits are set to reduce the need for early sale of an investment and are based on the availability of investments after each year-end.

6.11 The limits on interest rate exposure are as follows:

LIMITS ON INTEREST RATE EXPOSURE			
	2010/11 £000	**2011/12 £000**	**2012/13 £000**
Maximum Principal Sums Borrowed >364 days	6,589	6,553	6,467
Limits on fixed interest rates	100%	100%	100%
Limits on variable interest rates	20%	20%	20%

6.12 The upper and lower limits for the maturity structure of its borrowings as follows:

	Upper Limit %	Lower Limit %
Under 12 Months	20	0
12 Months and Within 24 Months	20	0
24 Months and Within 5 Years	40	0
5 Years and Within 10 Years	30	0
10 Years and Above	90	0

6.13 No investments will be placed for more than 364 days. Therefore the maximum sum Invested for more than 364 days is nil.

7 CURRENT DEBT PORTOFIO POSITION

7.1 The Council is not exposed to large fixed rate loans falling due for refinancing. The table below shows the currently estimated year-end position of the Council's debt portfolio, assuming no further borrowing in the current year.

DEBT MATURITY ANALYSIS		
	£000	**%**
Under 12 Months	71	12
12 Months and Within 24 Months	71	12
24 Months and Within 5 Years	195	34
5 Years and Within 10 Years	115	20
10 Years and Above	126	22
Total	**578**	**100**

8 ANNUAL INVESTMENT STRATEGY

8.1 ***Strategy Guidelines***

The main principle governing the Council's investment criteria is the security and liquidity of its investments before yield, although the yield or return on the investment will be a consideration, subject to adequate security and liquidity. The Council must ensure:

- ❖ It has sufficient liquidity in its movements. For this purpose it will set both a minimum amount to be held in short term investments (specified investments).
- ❖ It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counter parties with adequate security, and monitoring of their security.

  Note: A counter party list is maintained in compliance with this criteria and it will be revised and submitted to Council for approval as necessary. In accordance with new legislation, the proposed criteria detailed above are shown in notes 8.2 to 8.6 for approval.

8.2 ***Liquidity of Investments***

The Council expects to maintain average investment balances of £5.5m. The Council will continue to invest these on the London money market.

8.3 ***Specified Investments***

These investments are sterling investments of not more than one-year maturity. These are low risk assets and the possibility of loss of principal or investment income is very low. The investments are defined as:

i) The UK Government (such as the Debt Management Office, UK Treasury Bills or a gilt with less than one year to maturity).

ii) A local authority, parish council or community council.

iii) A body that has been awarded a high credit rating by a credit rating agency (such as a bank or building society). These bodies will have a minimum rating as set out in our counter party criteria and as listed in our Treasury Management Policy.

Note: Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested with these bodies. This criterion is also specified within the approved counter party criteria.

8.4 ***Non-Specified Investments***

Non-specified investments include any other type of investments, ie not defined as specified above. These are sterling investments with:

i) Securities admitted to the Officials List of the Stock Exchange that is guaranteed by the UK Government (such as supranational bonds).

ii) Gilt edged securities with a maturity of greater than one year.

iii) Institutions not meeting the basic security requirements under the specified investments.

iv) A body that has been awarded a high credit rating by a credit rating agency (such as a bank or building society) for deposits with a maturity of greater than one year.

At the present time the Council has no immediate plans to invest in non-specific investments.

8.5 ***The Monitoring of Investment Counter parties***

The credit rating of counter parties is monitored monthly. Any counter party failing to meet the criteria will be removed from the list immediately and, if required, new counter parties, which meet the criteria, will be added to the list.

8.6 ***Use of External Fund Managers***

It is the Council's policy not to use an external fund manager.