COUNCIL
9TH MARCH 2006

ITEM NO. ....

PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT STRATEGY REPORT 2006/07

Responsible Cabinet Member(s) – Councillor Don Bristow,
Resource Management Portfolio

Responsible Director(s) - Paul Wildsmith, Director of Corporate Services

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Purpose of Report

1. This report requests the Council to review and adopt the prudential indicators and limits within the report and approve the Treasury Management Strategy for 2006/07.

Summary

2. This is a statutory report and much of the content is in a prescribed format, which unfortunately means that it is relatively technical. However, the information contained in the report regarding the Council's Treasury Management and Prudential Borrowing activities are:
   (a) Within the statutory framework and consistent with the relevant codes of practice.
   (b) Prudent, affordable and sustainable.
   (c) An integral part of the Council's Revenue and Capital Medium Term Financial Plans.

Background

3. From 1st April 2004 local authorities were given extra freedoms with regard to borrowing. Prior to that date local authorities could only borrow with the approval of central government through the credit approvals procedures. As part of these new freedoms councils can borrow without recourse to central government, with the proviso that the additional borrowing is both prudent and affordable.

4. A framework was developed “The Prudential Code for Capital Finance” as part of this framework all authorities must report to Council at the beginning of each year certain statistics, the Prudential Indicators, that relate to capital expenditure and borrowing and what effect that borrowing will have on council tax levels and housing rent levels, other statistics relating to treasury management also have to be included.

5. Council must approve three statutory reports relating to the Prudential Code every year, one before the start of the year, one at the end of the financial year and one mid year.

Information and Analysis

Introduction and Headline Indicators

6. This report covers the operation of the Council's prudential indicators, its Treasury Management function and its likely activities for the forthcoming year. The report incorporates three key Council reporting requirements:

   a) The reporting of the main prudential indicators in accordance with the requirements of the CIPFA Prudential Code for Capital Finance in Local Authorities with a more detailed analysis in **Appendix 1**.

   b) The Treasury Management Strategy for 2006/07 in accordance with the CIPFA Code of Practice on Treasury Management incorporating the summary of the Investment Strategy (in accordance with the Office of the Deputy Prime Minister (ODPM) investment guidance) it also includes specific treasury management prudential indicators.

   c) The detailed investment criteria contained in **Appendix 2**.

7. A summary of the prudential indicators and limits are contained in **Tables 1** and **2** below.

Table 1

	2005/06 Revised	**2006/07 Estimated**	**2007/08 Estimated**	**2008/09 Estimated**
	£m	£m	£m	£m
Capital Expenditure	55.369	25.326	29.619	19.421
Capital financing requirement	93.231	99.758	102.824	105.121
Operational boundary for external debt	94.273	102.758	105.824	108.121
Authorised limit for external debt	108.414	118.172	121.697	124.339
Ratio of financing costs to net revenue stream – Non HRA	2.30%	2.99%	3.14%	3.27%
Ratio of financing costs to net revenue stream – HRA	10.71%	10.82%	12.60%	14.16%
Incremental impact of capital investment decisions on the band D Council Tax		2.15	5.04	7.81
Incremental impact of capital investment decisions on housing rents levels		Nil	Nil	Nil

Table 2

	2006/07 Upper		2007/08 Upper		2008/09 Upper	
Limits on fixed interest rates	100%		100%		100%	
Limits on variable interest rates	40%		40%		40%	
Maturity Structure of fixed interest rate borrowing						
	Lower	**Upper**	**Lower**	**Upper**	**Lower**	**Upper**
Under 12 months	0%	25%	0%	25%	0%	25%
12 months to 2 years	0%	40%	0%	40%	0%	40%
2 years to 5 years	0%	60%	0%	60%	0%	60%
5 years to 10 years	0%	80%	0%	80%	0%	80%
10 years and above	0%	100%	0%	100%	0%	100%
Maximum principal sums invested > 364 days	£10m		£10m		£10m	

8. This budgetary cycle provides for the third full year of the operation of the CIPFA Prudential Code. The Prudential Code operates by the provision of prudential indicators, which highlight aspects of the capital expenditure planning. Each indicator provided during the 2005/06 budget process has been updated and provided for the next three years. These are detailed below. This is in accordance with the Prudential Code, which requires that Council approve as a minimum certain mandatory indicators.

9. The purpose of the indicators is to provide a framework for capital expenditure decision-making. It highlights through the prudential indicators the level of capital expenditure; the impact on borrowing and investment levels and the overall controls in place to ensure the activity remains affordable, prudent and sustainable.

10. Within this overall capital expenditure framework there is a clear impact on the Council's treasury management activity, either through increased borrowing levels or the application of investment balances. As a consequence the Treasury Management Strategy for 2006/07 is included in this report. This report also includes the Treasury Management Prudential Indicators. The production of the Treasury Management Strategy is a requirement of the CIPFA Code of Practice on Treasury Management.

11. In addition, part of the Treasury Management Strategy requirements is the formulation of an investment strategy. Investment guidance issued by the ODPM during March 2004 overlaps into the Code of Practice requirements. The reporting requirements of the ODPM guidance have therefore been incorporated into the Treasury Management Strategy.

Capital Expenditure and the Capital Financing Requirement

12. The capital expenditure plans will be partially financed by resources such as capital receipts, capital contributions and capital grants. The remaining element, which cannot be immediately financed from other sources, will impact on the Council's underlying need to borrow, the Capital Financing Requirement (CFR). The summary of capital expenditure financing and the impact on the CFR are show in **Tables 3 and 4** below. This forms one of the required prudential indicators. A more detailed analysis from which the figures in this

report are drawn, breaking down the General Fund and the Housing Revenue Account split, and the impact on the Council's debt and investment levels, is shown in greater detail at **Appendix 1.**

13. A certain level of capital expenditure will be supported by the Government; anything above this level will be unsupported and will need to be financed from the Council's own resources.

14. There are two main limiting factors on the Council's ability to undertake unsupported capital expenditure.

    (a) Whether the revenue resource is available to support in full the implications of capital expenditure, both borrowing and ongoing running costs. i.e. Can the Council afford the implications of the unsupported borrowing?

    (b) The Government may use a long stop control to ensure that either the total of all Councils' plans do not jeopardise national economic policies, or in the event of an assessment by Central Government that local plans are unaffordable at a council, it may implement a specific control to limit its capital expenditure plans. No such control was implemented during 2004/05 or 2005/06 and there is no such indication of controls for 2006/07.

15. A risk of the plan is that the level of government support has been estimated for years 2007/08 and 2008/09 and is therefore subject to change. Similarly some of the estimates for other sources of funding such as capital receipts may be subject to change over this timescale.

16. The Council is asked to approve the capital expenditure projections below:

Table 3

	2004/05 Actual	**2005/06 Revised**	**2006/07 Estimate**	**2007/08 Estimate**	**2008/09 Estimate**
	£m	**£m**	**£m**	**£m**	**£m**
Capital Expenditure					
Total Expenditure	29.864	55.369*	25.326	29.619	19.421
Financed by:					
Capital Receipts	3.824	4.771	2.867	4.453	2.460
Capital Grants	13.762	21.699	10.394	16.741	9.334
Capital Contributions	0.369	1.478	0.112	0.100	0.100
Revenue	0.012	2.872	2.100	1.800	1.500
Net financing need for the year	11.897	24.549	9.853	6.525	6.027

* Including slippage of £16.824m from previous years

The Council's Borrowing Need (the Capital Financing Requirement)

17. The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total outstanding capital expenditure, which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying

borrowing need. The net capital financing need above will impact directly on the CFR. The Council is asked to approve the CFR projections below:

Table 4

	2004/05 Actual	2005/06 Revised	2006/07 Estimate	2007/08 Estimate	2008/09 Estimate
	£m	£m	£m	£m	£m
Capital Financing Requirement					
CFR – Non Housing	45.453	64.638	68.012	68.038	67.957
CFR – Housing	25.188	28.593	31.746	34.786	37.164
Total CFR	70.641	93.231	99.758	102.824	105.121
Net movement in CFR	10.842	22.590	6.527	3.066	2.297

18. The expected impact of the capital expenditure decisions on the Council's debt and investment position are shown below.

Limits to Borrowing Activity

19. Within the prudential indicators there are a number of key indicators to ensure the Council operates its activities within well defined limits.

20. The Council needs to ensure that its total borrowing net of any investments does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2006/07 and next two financial years. This allows some flexibility for limited early borrowing for future years.

Table 5

	2005/06 Revised	2006/07 Estimate	2007/08 Estimate	2008/09 Estimate
	£m	£m	£m	£m
Gross Borrowing	93.231	99.758	102.824	105.121
Investments	37.475	37.369	35.856	33.165
Net Borrowing	55.756	62.389	66.968	71.956
CFR	93.231	99.758	102.824	105.121

21. The Council complied with the prudential indicator requirement to keep net borrowing below the relevant CFR in the current year, and the above table confirms that no difficulties are envisaged for the current or future years. This view takes in account current commitments, existing plans and the proposals in the Revenue and Capital Medium Term Financial Plans.

22. A further two prudential indicators control the overall level of borrowing. These are:

23. **The Operational Boundary** – This indicator is based on the probable external debt during the course of the year; it is not a limit and actual borrowing could vary around this boundary for short times during the year. It should act as an indicator to ensure the authorised limit is not breached.

24. **The Authorised Limit** – This represents the limit beyond which borrowing is prohibited, and this limit needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable. It is expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

25. The Council is asked to approve the following operational and authorised limits.

Table 6

	2005/06 Revised	**2006/07 Estimate**	**2007/08 Estimate**	**2008/09 Estimate**
Operational Boundary	**£m**	**£m**	**£m**	**£m**
Borrowing as per Capital MTFP	91.273	99.758	102.824	105.121
Estimated additional supported borrowing	1.500	1.500	1.500	1.500
Prudential Borrowing to cover leasable assets	1.000	1.000	1.000	1.000
Possible Prudential Borrowing under Directors delegated powers	0.500	0.500	0.500	0.500
Operational Boundary	94.273	102.758	105.824	108.121
Additional Headroom as a % of Operational Boundary for External Debt	15%	15%	15%	15%
Authorised Limit	108.414	118.172	121.697	124.339

Affordability Prudential Indicators

26. The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the overall Council finances. The Council is asked to approve the following indicators:

27. **Actual and Estimates of the ratio of financing costs to net revenue stream** – This indicator identifies the trend in the cost of capital (borrowing costs net of investment income) against the net revenue stream.

Table 7 - Ratio of financing costs to net revenue stream

	2004/05 Actual	**2005/06 Comparator**	**2006/07 Estimate**	**2007/08 Estimate**	**2008/09 Estimate**
Non-HRA	1.36%	2.30%	2.99%	3.14%	3.27%
HRA	14.30%	10.71%	10.82%	12.60%	14.16%

28. The estimates of financing costs include current commitments and the proposals in Revenue and Capital MTFP reports.

29. **Estimates of the incremental impact of capital investment decisions on the Council Tax** This indicator identifies the trend in the cost of proposed changes in the three year capital programme recommended in this budget report compared to the Council's existing commitments and current plans. The forward assumptions are based on the assumptions included in the budget, but will invariably include some areas, such as the level of government support, which is not published over a three year period.

Table 8 - Incremental impact of capital investment decisions on the Band D Council Tax

	Proposed Budget 2006/07 £	**Forward Projection 2007/08 £**	**Forward Projection 2008/09 £**
Incremental impact of capital investment decisions on the Band D Council Tax.	2.15	5.04	7.81

30. **Estimates of the incremental impact of capital investment decisions on Housing Rent levels** – Similar to the Council tax calculation this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in this budget report compared to the Council's existing commitments and current plans, expressed as a change in weekly rent levels.

Incremental impact of capital investment decisions Housing Rent levels

Table 9

	Proposed Budget 2005/06 £	**Forward Projection 2006/07 £**	**Forward Projection 2007/08 £**
Weekly Housing Rents	Nil	Nil	Nil

31. In July 2004 Council approved a decision to prudentially borrow up to £20m over six years to invest in Council Housing in order to meet the Decent Homes Standard. Revenue savings in relation to maintenance costs and management and administration will be made within the Housing Revenue Account to ensure that there is to be no effect on Housing Rents.

Treasury Management Strategy 2006/07 – 2008/09

32. The Treasury Management service is an important part of the overall financial management of the Council's affairs. Its importance has increased as a result of the freedoms provided by the Code. It covers the borrowing and investment activities and the effective management of associated risks. Whilst the prudential indicators above consider the affordability and impact of capital expenditure decisions, the treasury management service covers the effective funding of these decisions. There are also specific treasury management prudential indicators which need approval.

33. The Council's activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management). This Council adopted the Code of Practice on Treasury Management on 21st March 2002 (Min. Ref. 63/Mar/2002 refers), and as a result adopted a Treasury Management Policy Statement. This adoption complies with one of the requirements of the Code.

34. The Treasury Management Policy requires an annual strategy to be reported to Cabinet/Council outlining the expected treasury activity for the forthcoming 3 years. Two further reports are produced one mid-year reporting on activity part way through the year and the other after the year-end to report on actual activity for the year.

35. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the Treasury Management service.

36. This strategy covers:

(a) The current Treasury Management position.
(b) The expected movement in interest rates.
(c) The Council's borrowing and debt strategy.
(d) The Council's investment strategy (in compliance with the Office of the Deputy Prime Minister (ODPM) guidance.
(e) Treasury Management performance indicators.
(f) Specific limits on Treasury Management activities.
(g) Local Treasury Management issues.

Current Treasury Management Position

Table 10

	2004/05 Actual £m	**2005/06 Revised £m**	**2006/07 Estimate £m**	**2007/08 Estimate £m**	**2008/09 Estimate £m**
External Debt					
Borrowing	72.228	92.988	99.549	102.652	104.989
Other Long Term Liabilities	0.286	0.243	0.209	0.172	0.132
Total Debt as at year-end.	72.514	93.231	99.758	102.824	105.121
Investments					
Total Investments as at year end.	35.300	37.475	37.369	35.856	33.165

Expected Movement in Interest Rates

37. There is always a risk to the Treasury Management Budget from an adverse move in interest rates. The Prudential Code is constructed on the basis of affordability, part of which is related to borrowing costs and investment returns. The Council employs Butlers, the treasury consultants, to advise on the Treasury Management Strategy, to provide economic data and interest rate forecasts, to assist planning and reduce the impact of unforeseen adverse

movements. Paragraphs 38 to 41 outline Butlers view of the UK and world economy and the effects this will have on UK interest rates.

38. *The Monetary Policy Committee announced the long-awaited cut in base rates following its August meeting. However, the down turn in the UK interest rates cycle is expected to be prolonged and shallow with the low point not being too wide of the 4.25% level (currently 4.5%). GDP growth had been substantially weaker than anticipated as the slowdown in house price inflation and higher debt servicing costs combined to undermine consumer spending growth. Activity is expected to remain weak at the start of 2006 but stage a recovery later in the year.*

39. *The Bank of England believes that the rebound in consumer activity, together with continued strength in public sector spending and a rise in corporate investment, will encourage higher growth in the future. This is open to debate and it is clear that the forecasting of interest rates in the current climate is difficult and a cautious approach is needed in treasury activity.*

40. *The international economic situation creates further uncertainty in the forecast. UK longer term interest rates have been influenced by US interest rates, which currently appear unrealistically low, and there continues to be risk of an upward shift in rates. The exact timing of this is however difficult to predict.*

Butlers Medium-Term Rate Forecasts* -Annual Averages %

Table 11

Percent	Base Rate	5-year Gilt	20-yr Gilt
2005/06	4.6	4.3	4.5
2006/07	4.3	4.4	4.6
2007/08	4.5	4.6	4.7
2008/09	4.8	4.8	4.7

* Butlers' forecasts (November 2005)

41. *There are significant risks to the forecast, which expects positive but low world and UK economic growth. Further weakness in growth could see short and longer term rates return to historic lows although there is a higher probability within the forecast that rates will return to historic norms and shift to a higher level.*

Borrowing and Debt Strategy 2006/07 – 2008/09

42. The introduction of the Prudential Code and some uncertainty over future interest rates increases the risks associated with the Treasury Management Strategy. As a result the Council will continue to take a cautious approach to its Treasury Management Strategy.

43. Long-term fixed interest rates are expected to rise modestly and base rates are expected to fall initially by 0.25% before rising again in 2007/08. The Director of Corporate Services, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above.

It is likely that longer term fixed rates will be considered if borrowing levels remain relatively low. This may include borrowing in advance of future years requirements.

44. With the likelihood of increasing interest rates any debt restructuring is likely to take place later in the financial year or in future years, although the Director of Corporate Services will monitor prevailing rates for any opportunities during the year.

45. During 2006/07 it is expected that the Council will need to borrow an additional £9.853m to cover part of its Capital Programme, see **Table 3,** and of this £4.243m will be supported by revenue grant through the Relative Needs Formula of the Revenue Grant Settlement. Although £5.610m will be unsupported, £3.300m for Housing Revenue Account already approved by Council and £2.310m proposed to be used to support the Capital MTFP for 2006/07.

Investment Strategy 2006/07-2008/09

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

    (a) It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may be prudently committed. These procedures also apply to the Councils prudential indicators covering maximum principal sums invested.

    (b) It maintains a policy covering both categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections in **Appendix 2** for approval.

47. The Director of Corporate Services will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit it to the Council for approval as necessary. This criteria is separate to that which chooses Specified and Non-Specified as it selects which counterparties the Council will choose rather than defining what its investments are.

    a) Banks - The Council will use banks which have at least the following Fitch ratings
        i) Short Term – F1
        ii) Long Term – A-
        iii) Individual – C
        iv) Support – 3
    b) Building Societies – the Council will use all Building Societies with assets in excess of £1,000m.
    c) Money Market Funds.
    d) UK Government including the Debt Management Office.
    e) Local Authorities.

48. In the normal course of the Council's cashflow operations it is expected that both specified and non-specified will be utilised for the control of liquidity as both categories allow for short term investments.

49. The use of longer term instruments (greater than one year from inception to repayment) will fall in the non-specified investment category. These instruments will only be used where the council's liquidity requirements are safeguarded. The investment prudential indicator below will also limit this.

Investment Interest Rates

50. Expectations on shorter-term interest rates, on which investment decisions are based, show a likelihood of falling by 0.25% in early 2006 and potentially rising again in 2007. The Council's investment decisions are based on comparisons between the rises priced into market rates against the Council's and advisers own forecasts. It is likely that investment decisions will be made for longer periods with fixed investments rates to lock in good value and security of return if opportunities arise. The Director of Corporate Services, under delegated powers, will undertake the most appropriate form of investments depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast.

Treasury Management Prudential Indicators and Limits on Activity

51. There are four Treasury Management Prudential Indicators. The purpose of these prudential indicators is to contain the activity of the Treasury Management function within certain limits, thereby reducing the risk or likelihood of an adverse movement in interest rates or borrowing decisions impacting negatively on the Council's overall financial position. However if these are set to be too restrictive they will impair the opportunities to reduce costs. The indicators are:

    (a) Upper limits on variable rate exposure – This indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments.

    (b) Upper limits on fixed rate exposure – Similar to the previous indicator this covers a maximum limit on fixed interest rates.

    (c) Maturity structures of borrowing – These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

    (d) Total principal funds invested for greater 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.

52. The Council is asked to approve the following prudential indicators:
Table 12

	2005/06		2006/07		2007/08	
	Upper		Upper		Upper	
Limits on fixed interest rates	100%		100%		100%	
Limits on variable interest rates	40%		40%		40%	
Maturity Structure of fixed interest rate borrowing						
	Lower	**Upper**	**Lower**	**Upper**	**Lower**	**Upper**
Under 12 months	0%	25%	0%	25%	0%	25%
12 months to 2 years	0%	40%	0%	40%	0%	40%
2 years to 5 years	0%	60%	0%	60%	0%	60%
5 years to 10 years	0%	80%	0%	80%	0%	80%
10 years and above	0%	100%	0%	100%	0%	100%
Maximum principal sums invested > 364 days	£10m		£10m		£10m	

53. **Table 13** below shows the maturity profile of debt outstanding at 31st March 2005.

Table 13

Analysis of Loans Maturity	Actual at 31st March 2005	
	£m	**%**
Under 12 months	1.125	0.3
12 months to 2 years	Nil	1.5
2 years to 5 years	Nil	0.0
5 years to 10 years	5.835	8.0
10 years and above	65.268	90.2
Total	72.228	100.0
Variable Debt	10.725	14.8

Performance Indicators

54. The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the Treasury Management function over the year. These are distinct historic performance indicators, as opposed to the Prudential Indicators, which are predominantly forward looking. Below are the performance indicators currently used by Darlington Borough Council for its Treasury Management function :-

(a) **Debt** – Average overall interest rate paid compared with previous years.

(b) **Investments – Short term** - cashflow investment rate returned against comparative average rates.

(c) **Investments – Longer term** - capital investment rates returned against comparative average rates.

The results of these indicators will be reported in the Treasury Management Half Year Review and Annual Reports for 2006/07.

Outcome of Consultation

55. Although no formal consultation has taken place the issues contained in this report were discussed at Resources Scrutiny Committee at their meeting on 8th February 2006, their comments were then considered at the special meeting of Cabinet on 1st March 2006.

Legal Implications

56. This report has been considered by the Borough Solicitor for legal implications in accordance with the Council's approved procedures. There are no issues which the Borough Solicitor considers need to be brought to the specific attention of Members, other than those highlighted in the report.

Section 17 of the Crime and Disorder Act 1998

57. The contents of this report have been considered in the context of the requirements placed on the Council by Section 17 of the Crime and Disorder Act 1998, namely, the duty on the Council to exercise its functions with due regard to the likely effect of the exercise of those functions on, and the need to do all that it reasonably can to prevent, crime and disorder in its area. It is not considered that the contents of this report have any such effect.

Council Policy Framework

58. This is a matter that is required to be considered by Council.

Recommendation

59. Council are requested to:-

(a) Adopt the prudential indicators and limits for 2006/07 to 2008/09 contained within this report in **Tables 3 to 10.**

(b) Approve the Treasury Management Strategy 2006/07 contained in paragraphs 32 to 54 and the treasury prudential indicators contained in **Table 12.**

(c) Approve the Investment Strategy 2006/07 contained in the Treasury Management Strategy, and the detailed criteria included in **Appendix 2**. Specifically approving the criteria for specified investments and the criteria for non-specified investments.

Reasons

60. The recommendations are supported by the following reasons: -

(d) In order to comply with the Prudential Code for Capital Finance in Local Authorities. and ODPM guidance on investments.

(e) To comply with the requirements of the Local Government Act 2003.

(f) To approve a framework for Officers to work within when making investment decisions.

Paul Wildsmith
Director of Corporate Services

Background Papers

CIPFA The Prudential Code for
Capital Finance in Local Authorities
Annual Statement of Accounts 2004/05

Elaine Hufford : Extension 2447

APPENDIX 1

	2004/05	2005/06	2006/07	2007/08	2008/09
	Actual £m	Comparator £m	Estimate £m	Estimate £m	Estimate £m
CAPITAL EXPENDITURE AND THE SOURCES OF FINANCE					
Capital Expenditure - General Fund					
Supported Spend	18.211	30.620	12.094	19.075	10.583
Unsupported Spend	5.046	14.297	2.310	0.000	0.000
Total Spend	23.257	44.917	14.404	19.075	10.583
Financed by					
Capital Receipts	1.929	3.176	1.867	3.453	1.460
Capital Grants	10.233	18.697	5.872	12.297	5.791
Capital Contributions	0.369	1.478	0.112	0.100	0.100
Revenue	0.012	0.422	0.000	0.000	0.000
Total	12.543	23.773	7.851	15.850	7.351
Net Capital Requirement	10.714	21.144	6.553	3.225	3.232
Capital Expenditure - Housing Revenue Account					
Supported Spend	6.607	8.990	7.622	7.244	6.043
Unsupported Spend	0	2.192	3.300	3.300	2.795
Total Spend	6.607	11.182	10.922	10.544	8.838
Financed by					
Capital Receipts	1.895	1.695	1.000	1.000	1.000
Capital Grants	3.530	3.632	4.522	4.444	3.543
Capital Contributions	0.0	0.0	0.000	0.000	0.000
Revenue	0.0	2.450	2.100	1.800	1.500
Total	5.425	7.777	7.622	7.244	6.043
Net Capital Requirement	1.182	3.405	3.300	3.300	2.795
Capital Expenditure - Total					
Supported Spend	24.817	38.880	19.716	26.319	16.626
Unsupported Spend	5.047	16.489	5.610	3.300	2.795
Total Spend	29.864	55.369	25.326	29.619	19.421
Financed by					
Capital Receipts	3.824	4.771	2.867	4.453	2.460
Capital Grants	13.762	21.699	10.394	16.741	9.334
Capital Contributions	0.369	1.338	0.112	0.100	0.100
Capital Reserves	0.000	0.140	0.000	0.000	0.000
Revenue	0.012	2.872	2.100	1.800	1.500
Total	17.967	30.820	15.473	23.094	13.394
Net financing need for the year	11.897	24.549	9.853	6.525	6.027

	2004/05 Actual £m	2005/06 Comparator £m	2006/07 Estimate £m	2007/08 Estimate £m	2008/09 Estimate £m
THE CAPITAL FINANCING REQUIREMENT					
The Capital Financing Requirement - General Fund					
Opening Balance		45.453	64.638	68.012	68.038
Net Capital Requirement Less MRP & VRP		19.775	3.970	0.507	0.513
Less Voluntary Set Aside		-0.590	-0.596	-0.481	-0.594
CFR Closing Balance	45.453	64.638	68.012	68.038	67.957
Net Movement in CFR		19.185	3.374	0.026	-0.081
The Capital Financing Requirement - Housing Revenue Account					
Opening Balance		25.188	28.593	31.746	34.786
Net Capital Requirement Less MRP & VRP		3.405	3.300	3.300	2.795
Less Voluntary Set Aside		0.000	-0.147	-0.260	-0.417
CFR Closing Balance	25.188	28.593	31.746	34.786	37.164
Net Movement in CFR		3.405	3.153	3.040	2.378
The Capital Financing Requirement – Total					
Opening Balance		70.641	93.231	99.758	102.824
Net Capital Requirement Less MRP & VRP		23.180	7.270	3.807	3.308
Less Voluntary Set Aside		-0.590	-0.743	-0.741	-1.011
CFR Closing Balance	70.641	93.231	99.758	102.824	105.121
Net Movement in CFR	10.781	22.590	6.527	3.066	2.297
EXERNAL DEBT & OTHER LONG TERM LIABILITIES					
Opening Balance 1st April	59.860	72.228	92.988	99.758	102.824
Maturing Debt	-0.215	-1.125	0.000	0.000	0.000
Borrowing - Maturing Debt	0.215	1.125	0.000	0.000	0.000
Borrowing adj at 31st March	1.587	-1.830	0.243	0.000	0.000
Borrowing change in CFR	10.781	22.590	6.527	3.066	2.297
Total Debt 31st March	72.228	92.988	99.758	102.824	105.121
Net movement in debt		20.760	6.770	3.066	2.297
Other long term liabilities	0.286	0.243	0.209	0.172	0.132

	2004/05 Actual £m	2005/06 Comparator £m	2006/07 Estimate £m	2007/08 Estimate £m	2008/09 Estimate £m
AUTHORISED LIMIT AND OPERATIONAL BOUNDARY					
Operational Boundary	84.379	91.273	99.758	102.824	105.121
Borrowing					
Amounts for additional supported borrowing		1.500	1.500	1.500	1.500
Prudential Borrowing to cover leasable assets		1.000	1.000	1.000	1.000
Prudential Borrowing under Directors delegated powers		0.500	0.500	0.500	0.500
Operational Boundary	84.379	94.273	102.758	105.824	108.121
15% Headroom	12.656	14.141	15.414	15.873	16.218
Authorised Limit	97.035	108.414	118.172	121.697	124.339
INVESTMENTS					
Opening Balance 1st April	26.870	35.300	37.475	37.369	35.856
Cash flow movements	3.430	2.175	2.500	0.000	0.000
Movements in reserves	5.000	0.000	-2.606	-1.513	-2.691
Total Investments 31 March	35.300	37.475	37.369	35.856	33.165
Net movement in investments	8.430	2.175	-0.106	-1.513	-2.691

Treasury Management Practice 1 (5)- Credit and Counterparty Risk Management

1. The Office of the Deputy Prime Minister issued investment guidance on 12th March 2004. In common with the relaxation of borrowing controls in the prudential system, the more flexible guidance on investment replaces the previous regulatory approach. These guidelines do not apply to either trust funds or pension funds, which are regulated by a different regulatory regime.

2. The key intention of the guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the Code on 21st March 2002 (Min. Ref. 63/Mar/2002 refers) and will apply its principles to all investment activity. In accordance with the Code the Director of Corporate Services has produced its Treasury Management Practices and this part TMP 1 (5), requires amendment.

Annual Investment Strategy 2006/07

3. The key requirements of both the code and the investment guidance are to set an annual investment strategy, as part its annual Treasury Management strategy for the following year, covering the identification and approval of the following:

   (a) The strategy guidelines for decision making on investments, particularly non-specified investments.
   (b) The principles used to determine the maximum periods for which funds can be committed.
   (c) Specified investments the Council will use. These are high security (i.e. high credit rating, although this defined by the Council, and no guidelines are given), and high liquidity of investments in sterling with a maturity of no more than a year. This will need to define broad categories of investment and regularity of monitoring.
   (d) Non-specified investments, clarifying the greater risk implications, identifying and general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

4. Specified and non-specified investments are both approved under the new guidance and both should normally form part of the Council's policy.

5. Throughout this Strategy the investments that will be used are Sterling fixed term or Variable deposits of up to 5 years with Banks and Building Societies, UK Government and other local authorities.

6. This Strategy is to be approved by Council.

Strategy Guidelines

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

   a) It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may be prudently committed. These procedures also apply to the Councils prudential indicators covering maximum principal sums invested.
   b) It maintains a policy covering both categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections below.

8. The Director of Corporate Services will maintain counterparty list in compliance with these criteria and will revise the criteria and submit it to Council for approval as necessary. The current proposed criteria are shown below

Liquidity of Investments

9. The Council will carefully balance the use of specified investments and non-specified investments into the future to ensure there is appropriate operational liquidity. In the normal course of the Council's cash flow operations it is expected that both specified and non-specified investments will be utilised for the control of liquidity as both categories allow for short term investments.

10. The use of longer term instruments (greater than one year from inception to repayment) will fall in the non-specified category. These instruments will only be used where the Council's liquidity requirements are safeguarded. An estimate of term investments is included in the main body of this report. The following estimates for longterm investments were included for the next three years 2006/07 £10m, 2007/08 £10m and 2008/09 £10m

11. These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the council has the right to be repaid within 12 months if it wishes. These are low risk assets where the possibility of loss of principal or investment income is negligible. These would include investments with:-

   a) The UK Government (such as the Debt Management Office, UK Treasury Bills or gilts).

   b) Supranational bonds.

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

   d) An investment scheme that has been awarded a high credit rating by a credit rating agency. This covers money market funds rated by Standard and Poors, Moody's or Fitch rating agencies

   e) A body that has been awarded a high credit rating by a credit rating agency (such as a bank or building society) This covers bodies with a minimum rating of :-

i) Short Term Rating- F1 (or equivalent) from Fitch, Moody's or Standard & Poors

ii) Long Term Rating- A or equivalent from Fitch, Moody's or Standard & Poors

iii) Individual / Financial Strength Rating – C from Fitch or Moody's Support Rating – 3 from Fitch

12. Within these bodies and in accordance with the code, the Council has set additional criteria to set the time limit and amount of monies which will be invested.

Non-Specified Investments

13. Non-specified investments are any type of other investment not defined as Specified and will include any investments for more than one year. These would include :-

a) Building Societies not meeting the basic security requirements under the specified investments. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings.

b) Any Bank or Building Society that has a minimum long term credit rating of A or equivalent for Fitch or Moody', for deposits with a maturity of greater than one year. This would include forward deals in excess of one year from inception to repayment.

14. The table 1 below shows the minimum credit rating (or asset size, relating to Building Society's) required for inclusion on the Council counterparty list.

Table 1

	Fitch				**Moody's**			**Asset Size**
Type	**Short Term**	**Long Term**	**Ind.**	**Support**	**Short Term**	**Long Term**	**Financial Strength**	
Bank	F1	A-	C	3				-
MMF	AAA				AAA			-
DMADF	-				-			-
Building Society (1)					P-1	A3	C	-
Building Society (2)	-	-	-	-	-	-	-	>£1bn

15. Table 2 shows investment time limits categorised between specified and non specified investments

Table 2

	Fitch				**Moody's**			**Asset Size**	
Type	**Short Term**	**Long Term**	**Ind**	**Support**	**Short Term**	**Long Term**	**Financial Strength**		**Time Limit**
Specified									
Bank / Building Society	F1	-	-	-	P-1				1 year
Building Society					P-2				9 months
MMF	AAA							-	1 year
DMADF	-				-			-	1 year
Non-Specified									
Un-rated BS	-	-	-	-	-	-	-	>£1bn	6 months
Long term Bank / BS	F1	A-	C	3	P-1	A3	C		2 years
	F1	AA-	B	2	P-1	Aa3	B		4 years
	F1	AAA	B	1	P-1	Aaa	B		5 years

The Monitoring of Investment Counterparties

16. The credit rating of counterparties is monitored regularly. The Council receives credit rating advice from its advisers, Butlers, on a daily basis as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria, will be removed from the list immediately by the Director of Corporate Services, and if required new counterparties which meet the criteria will be added to the list.