CABINET **APPENDIX 1**
3 FEBRUARY 2005

ITEM NO. ....6............

PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT STRATEGY REPORT 2005/06

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 2005/06

Background

2. At a Cabinet meeting on 6th January 2004 (Min Ref C171 refers) Members were made aware of the new regulations regarding Capital Finance and the production of Prudential Indicators in accordance with the Prudential Code for Capital Finance in Local Authorities (the Code). This report sets out the Prudential Indicators and the Treasury Management Strategy for 2005/06.

Summary

3. 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 2005/06 in accordance with the CIPFA code of Practice on Treasury Management incorporating the summary to the Investment Strategy (in accordance with the ODPM investment guidance) it also includes specific treasury management prudential indicators.

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

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

Table 1

	2004/05 Revised	**2005/06 Estimated**	**2006/07 Estimated**	**2007/08 Estimated**
	£000	£000	£000	£000
Capital Expenditure	46.298	28.661	20.427	16.518
Capital financing requirement	75.983	88.843	96.777	101.930
Operational boundary for external debt	84.379	94.273	102.207	107.360
Authorised limit for external debt	97.035	108.414	117.538	123.464
Ratio of financing costs to net revenue stream – Non HRA	1.71%	2.65%	3.32%	3.62%
Ratio of financing costs to net revenue stream – HRA	11.89%	11.22%	14.70%	18.57%
Incremental impact of capital investment decisions on the Band D Council Tax		£4.95	£20.28	£25.90
Incremental impact of capital investment decisions on housing rents levels		Nil	Nil	Nil

Table 2

	2005/06 Upper		**2006/07 Upper**		**2007/08 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	£7.5m		£7.5m		£7.5m	

Introduction

5. This budgetary cycle provides for the second 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 2004/05 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.

6. 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.

7. 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 2005/06 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.

8. 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.

Information and Analysis

Capital Expenditure and the Capital Financing Requirement

9. The capital expenditure plans will be partially financed by resources such as capital receipts, capital contributions and capital grants. The remaining element which can not 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.**

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

11. 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 and no national limits are anticipated to be imposed for 2005/06

12. A key risk of the plan is that the level of government support has been estimated 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.

13. The Council is asked to approved the capital expenditure projections below:

Table 3

	2003/04 Actual	**2004/05 Revised**	**2005/06 Estimate**	**2006/07 Estimate**	**2007/08 Estimate**
Capital Expenditure					
Total Expenditure	23.422	46.298*	28.661	20.497	16.518
Financed by:					
Capital Receipts	3.327	3.694	4.307	1.657	1.500
Capital Grants	11.518	23.047	9.221	8.093	6.793
Capital Contributions	0.345	1.065	0.100	0.100	0.100
Revenue	0.016	0.737	0.000	0.000	0.000
Net Capital Requirement	8.216	17.755	15.033	10.647	8.125

* Including slippage of £12. 835m from previous years

14. The capital expenditure projections detailed above are slightly different to the capital expenditure detailed in the Capital Medium Term Financial Plan. This is as a result of this report including the phasing of expenditure of schemes where the funding has previously been secured, whereas the Capital Medium Term Financial Plan only details new approvals that the Authority has received. The net Capital Requirement will impact directly on the CFR as detailed below. The Council is asked to approve the capital expenditure projections.

Table 4

	2003/04 Actual	**2004/05 Revised**	**2005/06 Estimate**	**2006/07 Estimate**	**2007/08 Estimate**
Capital Financing Requirement					
CFR – Non Housing	35.794	50.795	59.042	63.886	66.144
CFR – Housing	24.006	25.188	29.801	32.891	35.786
Total CFR	59.800	75.983	88.843	96.777	101.930
Net movement in CFR	N/A	16.183	12.860	7.934	5.153

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

Table 5

	2003/04 Actual	2004/05 Revised	2005/06 Estimate	2006/07 Estimate	2007/08 Estimate
External Debt					
Borrowing	62.230	78.413	91.273	99.207	104.360
Other Long Term Liabilities	0.000	0.000	0.000	0.000	0.000
Total Debt as at year-end.	62.230	78.413	91.273	99.207	104.360
Investments					
Total Investments as at year end.	26.870	29.570	28.900	30.430	27.600

Limits to Borrowing Activity

16. The Council needs to ensure that net external borrowing 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 2005/06 and next two financial years. This allows some flexibility for limited early borrowing for future years.

Table 6

	2004/05 Comparator	2005/06 Estimate	2006/07 Estimate	2007/08 Estimate
Gross Borrowing	78.413	91.273	99.207	104.360
Investments	29.570	28.900	30.430	27.600
Net Borrowing	48.843	62.373	68.777	76.760
CFR	75.983	88.843	96.777	101.930

17. The Council complied with the prudential indicator requirement to keep net borrowing below the relevant CFR in 2003/04, 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.

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

19. 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.

20. **The Authorised Limit –** This represents the limit beyond which borrowing is prohibited, and 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.

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

Table 7.

	2004/05 Comparator	**2005/06 Estimate**	**2006/07 Estimate**	**2007/08 Estimate**
Operational Boundary				
Borrowing as per Capital MTFP		91.273	99.207	104.360
Additional supported borrowing		1.500	1.500	1.500
Prudential Borrowing to cover leasable assets		1.000	1.000	1.000
Possible Prudential Borrowing under Directors delegated powers		0.500	0.500	0.500
Operational Boundary	84.379	94.273	102.207	107.360
Additional Headroom as a % of Operational Boundary for External Debt	15%	15%	15%	15%
Authorised Limit	97.035	108.414	117.538	123.464

Affordability Prudential Indicators

22. 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:

23. **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 8 - Ratio of financing costs to net revenue stream

	2003/04 Actual	**2004/05 Comparator**	**2005/06 Estimate**	**2006/07 Estimate**	**2007/08 Estimate**
Non-HRA	2.12%	1.71%	2.65%	3.32%	3.62%
HRA	10.15%	11.89%	11.22%	14.70%	18.57%

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

25. **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 9 - Incremental impact of capital investment decisions on the Band D Council Tax

	Proposed Budget 2005/06	Forward Projection 2006/07	Forward Projection 2007/08
Incremental impact of capital investment decisions on the Band D Council Tax.	4.95	20.28	25.90
% of total Band D Council Tax	0.51%	1.99%	2.43%`

26. **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 10

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

27. 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 2004/05 – 2006/07

28. 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.

29. 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.

30. 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.

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

32. 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) guidenance
(e) Treasury Management performance indicators
(f) Specific limits on Treasury Management activities
(g) Local Treasury Management issues

Current Treasury Management Position

33. Paragraph 15, earlier in the report, highlights both the current Treasury Management position and the expected movement in debt and investment levels over the next three years.

Expected Movement in Interest Rates

34. 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 35 to 43 outline Butlers view of the UK and world economy and the effects this will have on UK interest rates.

35. *The Bank of England's November Inflation Report tended to support the more optimistic view on UK interest rates that has developed in the financial markets since the autumn. The tone of the document suggests the Monetary Policy Committee will be content to leave policy on hold, although the possibility of one more hike to a peak of 5% cannot be ruled out entirely at this stage.*

36. The international backdrop appears to have become more benign. Overall growth in 2004 is expected to be at its strongest rate of 30 years but is expected to ease back in 2005, courtesy of tighter monetary conditions in the US, China and the UK and the deflationary impact of the rise in oil prices. Higher oil prices are likely to persist into the medium term, *after which, new supply should help alleviate the situation. Beyond 2005, global GDP growth is forecast to assume a steady profile.*

37. *In the UK, the economic backdrop again appears to have become more benign. The housing market has finally begun to slow down and the Bank is hinting that house price inflation, rather than slowing to zero, could well move into modestly negative territory. Significantly, the Bank suggests that the close relationship between house price inflation and spending growth has weakened. Consequently, falling house prices may not be accompanied by a sharp decline in consumers' expenditure. The continued buoyancy of the labour market may have something to do with this.*

38. *UK growth is expected to decelerate, although the Bank doubts the accuracy of the official industrial production data, which has been very weak for a number of months. Nevertheless, it suggests GDP growth will slow more quickly than has been projected in August. However, the extent of the deceleration may be more modest. The depreciation in sterling should deliver a boost via en eventful improvement in the trade balance.*

39. *On the inflation front, the annual rate of increase in CPI is expected to rise to 2% two years hence and a little more thereafter. Some supply bottlenecks, higher energy prices and the adverse effects of currency depreciation are cited as principal reasons for this. Nevertheless, the Bank does not anticipate a marked pick-up in labour costs and points to the grater stability in the service sector.*

40. *The report does stress that there are a huge number of uncertainties overshadowing the domestic as well as international backdrop. While some of these could lead it to resume a policy of tightening the "overall risks to growth and inflation are somewhat on the downside"*

41. *The expected movement in interest rates are as follows:*

Butlers Medium-Term Rate Forecasts
Table 11

Percent	**Base Rate**	**5-year Gilt**	**20-yr Gilt**
2004/05	4.6	4.8	4.9
2005/06	4.6	4.7	4.8
2006/07	4.3	4.5	4.6
2007/08	4.8	5.0	5.1

42. *The key risks to the forecasts surround the strength of the US recovery. Since this will be the key driver of world growth, and like the UK borrowing drives much of the growth, a fall in consumer confidence may see the US recovery falter and the upward pressure on UK short and long-term fixed rates will cease.*

43. *Similarly the US recovery may ignite the world economy seeing strong and sustainable world growth, increasing inflationary pressures and a higher than expected increase in short and long-term rates."*

Borrowing and Debt Strategy 2005/06 – 2007/08

44. 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.

45. Long-term fixed interest rates are expected to rise and base rates are expected to remain relatively flat. 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 if base rates are relatively cheap borrowing will be kept short pending longer term rates falling.

46. With increasing interest rates any debt rescheduling is likely to take place early in the financial year, although the Director of Corporate Services will monitor prevailing rates for any opportunities during the year.

47. During 2005/06 it is expected that the Council will need to borrow an additional £15.033m to cover part of its Capital Programme, see **Table 3,** and of this £6.133m will be supported by revenue grant through the Capital Financing block of the Formula Spending Share. Although £8.900m will be unsupported, £3.400m for Housing Revenue Account already approved by Council and £5.500m proposed to be used to support the Capital MTFP for 2005/06.

Investment Strategy 2005/06-2007/08

48. 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.

49. 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

50. 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.

51. 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

52. Expectations on shorter-term interest rates, on which investment decisions are based, show a likelihood of remaining stable during the first half of 2005/06, with the risk of falling after this. 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. 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 in **Table 11.**

Treasury Management Prudential Indicators and Limits on Activity

53. 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.

54. 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	£7.5m		£7.5m		£7.5m	

55. **Table 13** below shows the maturity profile of debt outstanding at 31st March 2004.

Table 13

Analysis of Loans Maturity	Actual at 31st March 2004	
	£m	**%**
Under 12 months	Nil	
12 months to 2 years	1.125	1.8
2 years to 5 years	Nil	
5 years to 10 years	4.836	7.8
10 years and above	56.269	90.4
Total	62.230	100.0
Variable Debt	10.725	17.2

Performance Indicators

56. 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 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 2005/06.

Outcome of Consultation

57. The issues contained in this report do not require formal consultation.

Legal Implications

58. 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

59. 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

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

Decision Deadline

61. For the purpose of the 'call-in' procedure this does not represent an urgent matter. However, this item is being considered by a special meeting of the Resources Scrutiny Committee on 7th February 2005.

Key Decisions

62. This is a Key Decision and as such has been reported on the Forward Plan.

Recommendation

63. It is recommended that :-

(a) The Council adopt the prudential indicators and limits for 2005/06 to 2007/08 contained within this report in **Tables 3 to 10**

(b) Council approve the Treasury Management Strategy 2005/06 contained in paragraphs 28 to 56 and the treasury prudential indicators contained in **Table 12**

(c) Approve the Investment Strategy 2005/06 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

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

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

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

(c) 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 2003/04

Elaine Hufford : Extension 2447

APPENDIX 1

	2003/04	2004/05	2005/06	2006/07	2007/08
	Actual £'000	**Comparator £'000**	**Estimate £'000**	**Estimate £'000**	**Estimate £'000**
CAPITAL EXPENDITURE AND THE SOURCES OF FINANCE					
Capital Expenditure - General Fund					
Supported Spend	16,226	30,512	13,174	8,117	6,874
Unsupported Spend	0	8,718	5,500	4,100	1,431
Total Spend	16,226	39,230	18,674	12,217	8,305
Financed by					
Capital Receipts	1,937	1,676	2,507	157	0
Capital Grants	7,976	19,499	5,647	4,613	3,380
Capital Contributions	345	1,065	100	100	100
Revenue	16	417	0	0	0
Total	10,274	22,657	8,254	4,870	3,480
Net Capital Requirement	5,952	16,573	10,420	7,347	4,825
Capital Expenditure - Housing Revenue Account					
Supported Spend	7,196	7,068	6,587	4,980	4,913
Unsupported Spend	0	0	3,400	3,300	3,300
Total Spend	7,196	7,068	9,987	8,280	8,213
Financed by					
Capital Receipts	1,390	2,018	1,800	1,500	1,500
Capital Grants	3,542	3,548	3,574	3,480	3,413
Capital Contributions	0	0	0	0	0
Revenue	0	320	0	0	0
Total	4,932	5,886	5,374	4,980	4,913
Net Capital Requirement	2,264	1,182	4,613	3,300	3,300
Capital Expenditure - Total					
Supported Spend	23,422	37,580	19,761	13,097	11,787
Unsupported Spend	0	8,718	8,900	7,400	4,731
Total Spend	23,422	46,298	28,661	20,497	16,518
Financed by					
Capital Receipts	3,327	3,694	4,307	1,657	1,500
Capital Grants	11,518	23,047	9,221	8,093	6,793
Capital Contributions	345	1,065	100	100	100
Revenue	16	737	0	0	0
Total	15,206	28,543	13,628	9,850	8,393
Net Capital Requirement	8,216	17,755	15,033	10,647	8,125

	2003/04 Actual £'000	2004/05 Comparator £'000	2005/06 Estimate £'000	2006/07 Estimate £'000	2007/08 Estimate £'000
THE CAPITAL FINANCING REQUIREMENT					
The Capital Financing Requirement - General Fund					
Opening Balance	0	35,794	50,795	59,042	63,886
Net Capital Requirement Less MRP & VRP	0	15,001	8,247	4,844	2,258
Less Voluntary Set Aside	0	0	0	0	0
CFR Closing Balance	35,794	50,795	59,042	63,886	66,144
Net Movement in CFR	0	15,001	8,247	4,844	2,258
The Capital Financing Requirement - Housing Revenue Account					
Opening Balance	0	24,006	25,188	29,801	32,891
Net Capital Requirement Less MRP & VRP	0	1,182	4,613	3,090	2,895
Less Voluntary Set Aside	0	0	0	0	0
CFR Closing Balance	24,006	25,188	29,801	32,891	35,786
Net Movement in CFR	0	1,182	4,613	3,090	2,895
The Capital Financing Requirement - Total					
Opening Balance	0	59,800	75,983	88,843	96,777
Net Capital Requirement Less MRP & VRP	0	16,183	12,860	7,934	5,153
Less Voluntary Set Aside	0	0	0	0	0
CFR Closing Balance	59,800	75,983	88,843	96,777	101,930
Net Movement in CFR	0	16,183	12,860	7,934	5,153
EXERNAL DEBT & OTHER LONG TERM LIABILITIES					
Opening Balance 1st April	0	62,230	78,413	91,273	99,207
Maturing Debt	0	-93	-1,125	0	0
Borrowing - Maturing Debt	0	93	1,125	0	0
Borrowing adj at 31st March	0	62,230	78,413	91,273	99,207
Borrowing change in CFR	0	16,183	12,860	7,934	5,153
Total Debt 31st March	62,230	78,413	91,273	99,207	104,360
Net movement in debt	0	16,183	12,860	7,934	5,153
Other long term liabilities	0	0	0	0	0

	2003/04 Actual £'000	2004/05 Comparator £'000	2005/06 Estimate £'000	2006/07 Estimate £'000	2007/08 Estimate £'000
AUTHORISED LIMIT AND OPERATIONAL BOUNDARY					
Operational Boundary Borrowing			91,273	99,207	104,360
Amounts for additional supported borrowing			1,500	1,500	1,500
Prudential Borrowing to cover leasable assets			1,000	1,000	1,000
Prudential Borrowing under Directors delegated powers			500	500	500
Operational Boundary	72,342	84,379	94,273	102,207	107,360
15% Headroom		12,656	14,141	15,331	16,104
Authorised Limit		97,035	108,414	117,538	123,464
INVESTMENTS					
Opening Balance 1st April		26,870	29,570	28,900	30,430
Cash flow movements		1,300	330	0	0
Movements in reserves		1,400	-1,000	1,530	-2,830
Total Investments 31 March	26,870	29,570	28,900	30,430	27,600
Net movement in investments	0	2,700	-670	1,530	-2,830

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 current 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 2005/06

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 2005/06 £7.5m, 2006/07 £7.5m and 2007/08 £7.5m

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, or those on the minimum criteria placed on negative Creditwatch, 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.