RIBBLE VALLEY BOROUGH COUNCIL
REPORT TO POLICY & FINANCE COMMITTEE

DECISION

Agenda Item No 11a

meeting date: 29 MARCH 2011
title: TREASURY MANAGEMENT STRATEGY
submitted by: DIRECTOR OF RESOURCES
principal author: TRUDY HOLDERNESS

1 PURPOSE

1.1 To seek member approval for the Council's Treasury Management Strategy for the 2011/12 financial year.

2 BACKGROUND

2.1 The Prudential Code for Capital Finance in Local Authorities (the Code) initially came into effect from 1 April 2004. It was revised in 2009 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 and underpins the system of capital finance. Local authorities determine their own programmes for capital investment in fixed assets that are central to the delivery of quality local public services. The Prudential Code has been developed as a professional code of practice to support them in taking these 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 was published in November 2009 following the House of Commons Select Committee and Audit Commissions investigations into the collapse of the Icelandic banks.

2.5 Key changes included enhanced scrutiny roles for those charged with governance, more transparent reporting requirements and greater emphasis on the requirements for ensuring those charged with governance have sufficient skills to adequately perform their role.

2.6 Theses key changes are included in the following requirements:

- ❖ Minimum reporting requirement – the council should receive at least three reports during the year:
    - one prior to the start of the financial year which sets out the strategy on the proposed treasury management activities for the year and a review of the organisations approved treasury management policy statement and practices
    - a mid-year review; and
    - one after the close of the financial year reporting operational activity.

- 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, which is then formally approved by Full Council.

2 THE TREASURY MANAGEMENT STRATEGY

2.8 The treasury management code requires the council 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.

2.9 A key requirement of the strategy is to explain both the risks and the management of the risks associated with the treasury service.

2.10 The attached strategy at Annex 1 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

2.11 The Treasury management strategy

3 RECOMMENDED THAT COMMITTEE

3.1 Recommend to Council the Treasury Management Strategy as set out in Annex 1.

SENIOR ACCOUNTANT

PF24-11/TH/AC
18 MARCH 2011

MARCH 2011

RIBBLE VALLEY

BOROUGH COUNCIL

TREASURY MANAGEMENT STRATEGY 2011/12

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Current Treasury Position

1.1 The Council's treasury position is summarised below. A more detailed report on the Council's treasury management activity for the 2010/11 financial year will be submitted to this committee by September.

	31 March 2010 Actual £	Actual Average Rate %	31 March 2011 Estimate £	Estimated Average Rate %
Fixed Rate Debt	578,131	4.7	507,024	4.9
Short Term Borrowing	0	0.5	0	0.4
Net Borrowing	**578,131**		**507,024**	

1.2 The above table shows that at the 31 March 2010 the Council's net borrowing was £578K. All of this borrowing is from the Public Works Loans Board and is gradually decreasing as payments of the principle are made year by year. It estimated that the outstanding principle on all PWLB loans at 31 March 2011 will be £507K.

1.3 The above PWLB debt comprises of the following individual loans:

Original loan Amount £	Term	Interest Rate	Estimated Principal Outstanding at 31 March 2011 £	Year of Final Repayment
250,000	7 years	4.50% Fixed	125,000	2014/15
250,000	10 years	4.60% Fixed	162,500	2017/18
250,000	15 years	4.75% Fixed	4,524	2022/23
250,000	25 years	4.88% Fixed	215,000	2032/33
			507,024	

1.4 The Council's current treasury position is not at risk from movements in interest rates as all current PWLB borrowing is on fixed rate. Should the council choose to take any future borrowing on variable rates this would expose the council to a greater risk from any adverse movement in interest rates.

1.5 There was no short term borrowing at the 31 March 2010, and none is anticipated at the 31 March 2011. Only very occasionally has the Council utilised short term borrowing in order to temporarily aid cash flow.

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 GDP was provisionally estimated to have fallen by 0.5% in the final quarter (Q4) of 2010. However the Office of National Statistic (ONS) estimated that without the disruption by heavy snow, output would have been broadly flat. However excluding the effects of snow, growth around the turn of the year appears to have been weaker than expected in the November Inflation report.

2.5 Growth in the first quarter (Q1) of 2011 is likely to be boosted as activity rebounds. Stimulus from monetary policy, together with a further expansion in world demand and past depreciation of sterling, should support recovery by encouraging private sector spending and some rebalancing of the economy. The strength of the recovery is likely to de dampened from the effects of higher commodity prices and the impact of the recession on productivity and household income

2.6 CPI inflation rose to 3.7% in December and is likely to rise up to between 4% and 5% in the near term, and to remain well above the 2% target throughout 2011 and beyond.

2.7 The elevated level of inflation reflects the temporary impact of three factors, increases in the standard rate of VAT, higher energy prices and higher import prices. Inflation is likely to fall back as those effects diminish. However the outlook remains uncertain.

2.8 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 %
2011 Q1	2.30
2011 Q2	1.68
2011 Q3	1.68
2011 Q4	2.68
2012 Q1	2.71
2012 Q2	2.96
2012 Q3	3.04
2012 Q4	3.03
2013 Q1	2.96

2.9 At the MPC February meeting, the committee judged it likely that growth would resume and that inflation would remain well above the target for the next year or so. Under the assumption that bank base rate rose in line with market yields, inflation was likely to fall back to around target in the medium term, as the temporary impact of the factors currently raising inflation waned and some downward pressures from a margin of spare capacity persisted. The MPC judged that it was appropriate to maintain bank base rate at 0.5% and its stock of purchased assets at £200 billion, in order to meet the 2% CPI inflation target over the medium term.

2.10 In the period leading up to the MPC's February decision, the path implied by forward market interest rates was for Bank Rate to rise to 1%, on average, in 2011 Q4. Bank Rate was assumed to continue to rise thereafter, with the path 0.8 percentage points higher, on average, over the remainder of the forecast period than assumed in the November Inflation report. The expected movement in interest rates is shown below:

	Base Rates %	
	November 2010	February 2011
2011 Q1	0.5	0.60
2011 Q2	0.5	0.70
2011 Q3	0.6	0.80
2011 Q4	0.7	1.00
2012 Q1	0.8	1.20
2012 Q2	0.9	1.50
2012 Q3	1.1	1.80
2012 Q4	1.2	2.10
2013 Q1	1.4	2.30
2013 Q2	1.6	2.60
2013 Q3	1.7	2.80
2013 Q4	1.9	2.90
2014 Q1		3.10

2.11 Public Works Loan Board interest rates show a similar pattern in the near term.

	Fixed Rate %
1 –2 years	2.07
5 - 6 Years	3.08
20 – 25 Years	5.19

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

Borrowing and Debt Strategy 2011/12 – 2013/14

3.1 The introduction of the Prudential Code and uncertainty over future interest rates increases the risks associated with the treasury strategy should the council need to increase its use of short term borrowing or make further longer term borrowing on a variable rate. 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. As part of the Comprehensive Spending Review on 20 October 2010, the interest rate on PWLB loans was raised from 0.2 percent to 1 percent above UK Government gilts. This will impact on any future decisions that the Council may make to borrow from the PWLB.

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.

Investment Strategy 2011/12 – 2013/14

4.1 Expectations on shorter-term interest rates, on which investment decisions are based, show a likelihood that rates will remain at their current low levels, but again may change sharply as government act 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.

4.3 The council's investment priorities are the security of capital and the liquidity of its investments

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 external grants
- From contributions from revenue or earmarked reserves

5.2 The use of prudential borrowing will be limited to assets with long assets lives such as buildings and land.

Limits on Treasury Management Activities and Prudential Indicators 2011/12 – 2013/14

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.

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.

6.3 The council has only agreed a capital programme for the 2011/12 financial year and the prudential indicators are prepared based on this. A capital working group is to review and suggest a capital programme for the years 2012/13 to 2015/16 which is affordable and achievable.

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

Capital Financing Requirement				
31/03/10 Actual £'000	**31/03/11 Revised Estimate £'000**	**31/03/12 Estimate £'000**	**31/03/13 Estimate £'000**	**31/03/14 Estimate £'000**
3,701	4,144	4,104	3,967	3,833

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

	Authorised Limit for External Debt		
	2011/12 £'000	**2012/13 £'000**	**2013/14 £'000**
Borrowing	12,226	11,994	11,968
Other Long-Term Liabilities	0	0	0
Total	**12,226**	**11,994**	**11,968**

6.6 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.

6.7 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.

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

Operational Boundary for External Debt			
	2011/12 £'000	**2012/13 £'000**	**2013/14 £'000**
Borrowing	7,601	7,562	7,425
Other Long Term Liabilities	0	0	0
Total	**7,601**	**7,562**	**7,425**

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

6.10 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.

6.11 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.

6.12 The limits on interest rate exposure are as follows:

LIMITS ON INTEREST RATE EXPOSURE			
	2011/12 £000	**2012/13 £000**	**2013/14 £000**
Maximum Principal Sums Borrowed >364 days	7,601	7,562	7,425
Limits on fixed interest rates	100%	100%	100%
Limits on variable interest rates	20%	20%	20%

6.13 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

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

Current Debt Portfolio 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.

ESTIMATED DEBT MATURITY ANALYSIS AS AT 31 MARCH 2011		
	£'000	**%**
Under 12 Months	71	14.02
12 Months and Within 24 Months	71	14.02
24 Months and Within 5 Years	160	31.51
5 Years and Within 10 Years	89	17.65
10 Years and Above	116	22.80
Total	**507**	**100.00**

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 we will maximise the use of the council's online HSBC facility to place money either overnight or on a short-term basis.
- 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 £4.1m. 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.