

EAST AYRSHIRE COUNCIL

CABINET– 2 APRIL 2008

TREASURY MANAGEMENT ANNUAL STRATEGY REPORT FOR 2008/2009

Report by Executive Head of Finance and Asset Management

1. PURPOSE OF REPORT

- 1.1** To seek the approval of Cabinet of the proposed Treasury Management Strategy for the financial year 2008/09 and the prudential indicators in relation to treasury activity which are required to be set and approved by the Council in advance of the financial year.

2. BACKGROUND INFORMATION

- 2.1** The Local Government in Scotland Act 2003 (via regulation) requires the Council to adopt the CIPFA Prudential Code. The code operates by the provision of prudential indicators and requires the production of an annual treasury management strategy.
- 2.2** A report to Cabinet on 13 February 2008 sought Members' approval of the prudential indicators relating to capital expenditure plans, borrowing levels and affordability. These indicators considered the affordability and impact of capital expenditure decisions. There are further prudential indicators which cover the effective funding of these decisions through treasury activity which require approval and are included in this report.
- 2.3** Treasury Management activities are strictly regulated by statutory requirements and by the CIPFA Code of Practice for Treasury Management in the Public Services and the first prudential indicator in respect of Treasury Management is that the local authority has adopted this code. This council adopted the code on 2 May 2002, and as a result adopted a Treasury Management Policy and Practices Statement which requires that the Executive Head of Finance & Asset Management reports on annual treasury strategy to Cabinet outlining the forecast activity for the coming year. A further report is produced after the year end to report on actual activity for the year.
- 2.4** A key requirement of the strategy report is to explain the risks and the management of these risks that are associated with the treasury management service. This strategy report covers: -
- The current treasury position
 - The expected movement in interest rates
 - The Council's borrowing and investment strategies
 - Treasury performance indicators and limits on activity

3. THE CURRENT TREASURY POSITION

3.1 Capital Expenditure

The councils approved capital investment plans are summarised below;

	2007/08 Projection £M	2008/09 Estimated £M	2009/10 Estimated £M	2010/11 Estimated £M
Capital Expenditure :				
Forecast Expenditure 2007/08	46.830			
Previously Approved Projects		5.593	4.798	0.956
New Projects 19 December 2007		20.000	20.000	20.000
Total General Services	46.830	25.593	24.798	20.956
Housing Revenue Account (HRA)	14.777	15.592	15.616	15.026
Total Gross Capital Expenditure	61.607	41.185	40.414	35.982
Financed By :				
Capital Receipts	8.000	6.500	4.888	3.640
Grants & Partnership Funding	16.207	0.000	0.000	0.000
Revenue (CFCR)	3.561	5.561	5.561	5.561
Total Financing	27.768	12.061	10.449	9.201
Net Financing need for the year	33.839	29.124	29.965	26.781

The table above represents the maximum financing need and may be reduced following a review over the next few months of ring fenced funding within the Capital Grants included in the council's overall grant settlement.

3.2 Capital Financing Requirement

This indicator shows the resultant cumulative amount that the council will need to borrow to fund the capital programme at the end of each year and was approved by Cabinet on 13 February 2008.

	2007/08 Projected £M	2008/09 Estimated £M	2009/10 Estimated £M	2010/11 Estimated £M
CFR - General Services	158.464	176.007	191.814	202.578
CFR - HRA	55.577	58.362	62.687	67.526
Total Capital Financing Requirement (CFR)	214.041	234.369	254.501	270.104
Movement in CFR	26.499	20.328	20.132	15.603
Represented by :				
Net Financing need for the year (above)	33.839	29.124	29.965	26.781
Principal Repayments (on previous expenditure)	(7.340)	(8.796)	(9.833)	(11.178)
	26.499	20.328	20.132	15.603

3.3 Authorised Limit for External Debt

This indicator sets a limit on the level of borrowing gross of investments for each financial year and was set by approved by Cabinet on 13 February 2008. It includes a degree of headroom to cope with, for example unusual cash movements as well as allowing amounts required for the approved capital plans for future years to be borrowed where considered prudent.

	2007/08 Revised £M	2008/09 Estimated £M	2009/10 Estimated £M	2010/11 Estimated £M
Authorised limit for external debt	281.256	299.400	301.916	303.867

3.4 Operational Boundary for External Debt

This indicator represents the most likely maximum level of external debt. It is a management tool used for in-year monitoring purposes.

	2007/08 Revised £M	2008/09 Estimated £M	2009/10 Estimated £M	2010/11 Estimated £M
Operational boundary for external debt	275.905	293.541	295.554	297.114

3.5 Current Position

The following table shows the current Debt held by the council and the anticipated future levels of investments held. These levels are well below the Capital Financing Requirement and authorised and operational boundaries above and new borrowing is required over the forthcoming year.

	Projected Balance 31/03/08 £M	Average Interest Rate %	Projected Balance 31/03/09 £M	Projected Balance 31/03/10 £M
PWLB	123.319	6.52%	123.308	123.169
Market Loans	66.600	4.45%	66.600	66.600
Other	0.858	5.42%	0.803	0.775
Total Debt	190.777	5.79%	190.711	190.544
Investments	(48.000)	5.70%	(40.000)	(40.000)

4. EXPECTED MOVEMENT IN INTEREST RATES

4.1 The Council's treasury management advisors – Butlers provide regular interest rate forecasts the most recent of which is as follows.

Interest Rate Forecasts 2007/09

Year	End Period	Base Rate	5-year Gilt	20-yr Gilt	50-yr Gilt
2008	Mar	5.25%	4.60%	4.60%	4.40%
	Jun	5.00%	4.70%	4.70%	4.50%
	Sept	4.75%	4.70%	4.70%	4.50%
	Dec	4.75%	4.70%	4.80%	4.60%
2009	Mar	4.75%	4.80%	4.80%	4.60%

*PWLB borrowing is normally between 0.1-0.15% above the equivalent gilt yield

5. BORROWING AND DEBT STRATEGY 2008/09- 2010/11

- 5.1** The uncertainty over future interest rates increases the risks associated with treasury activity and the Council will continue to take a cautious approach to its treasury strategy.
- 5.2** The Council's estimated net borrowing requirement for 2007/08 and future years based on the capital financing requirement in 3.2 above is shown in the table below.

	2007/08	2008/09	2009/10	2010/11
	Projected £M	Estimated £M	Estimated £M	Estimated £M
Movement in CFR	26.499	20.328	20.132	15.603
Borrowing over CFR brought forward	(3.820)	-	-	-
Borrowing Requirement	22.679	20.328	20.132	15.603

- 5.3** The combined borrowing requirement total for 2007/08 to 2010/11 is £78.742M. As shown in 3.5 above there is no material change in the council's existing external borrowing over this period and therefore there is an underlying need to borrow these funds. The prudential code permits borrowing for additional financing requirements for the current and next two financial years .
- 5.4** Interest rates are currently fluctuating and as at present the council has cash reserves in excess of £40M these reserves will be used to fund capital expenditure in the short term allowing any borrowing to be undertaken at the most opportune time.
- 5.5** The major factor in our borrowing decision making is stability for future years which takes precedence over any opportunities which may yield short term benefits but create longer term uncertainty. Therefore a trigger point of 4.4% has been set in consultation with our treasury advisors and should interest rates fall to this level the intention is to borrow at fixed rates from the PWLB for periods between 40 to 44 years or 48 to 50 years. This gives both stability and fits with our current debt maturity profile.

- 5.7** This position remains under regular review and further decisions will be taken in conjunction with advice from our consultants on how best to source any remaining requirement over the next three years.
- 5.8** With changes in accounting treatment from 1 April 2007 debt restructuring of existing debt is less financially beneficial than previously and therefore less likely, although the Executive Head of Finance and our treasury consultants will monitor prevailing rates for any opportunities during 2008/09.

6. INVESTMENT STRATEGY 2008/09 - 2010/11

- 6.1** The main principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment will also be a consideration. Adopting this main principle, action will be taken to ensure:
- (a)** There is sufficient liquidity within the investment portfolio. For this purpose consideration will be taken of the maximum periods for which funds may be prudently committed taking into account the current statutory limit of 364 days on the investment periods.
- (b)** That a policy is maintained covering the categories of investment types selected to invest in, the criteria for choosing investment counterparties with adequate security, and the monitoring of their security.
- 6.2** In compliance with the approved Treasury, Policies and Practices investments can only be placed with counterparties whose credit ratings meet qualifying credit rating criteria. The advantage to this is that counterparties are under constant review. The criteria which were set on advice from our Treasury advisors and are contained in the council's approved Treasury Policies and Practices are:-

	Fitch	Moody's	Standard & Poors	Money Limit	Time Limit
Upper Limit	F1 / AA - / C / 3	P-1 / Aa3 / C	A-1 / AA-	£10m	364 days
Middle Limit	F1 / A- / C / 3	P-1 / A3 / C	A-1 / A-	£7.5m	364 days
Lower limit	Building Societies with assets greater than £1b and unrated subsidiaries whose parents fit into the upper and middle limits above			£5m	6 months
Other Institutions	Other UK Local Authorities and Public Bodies e.g. fire, police etc			£10m	364 days

Note

There are 4 possible ratings for counterparties as detailed above: Short Term / Long Term / Individual / Support. In the above table Moody's do not utilise a Support Rating whilst Standard & Poors only provide criteria on Short and Long Term borrowing.

No more than 25% of the total investment portfolio should be placed with any single counterparty at the date of entering the transaction.

- 6.3** Any surplus funds where practical will be invested where the maximum rate of return is available subject to the council's cash flow requirements and the above counterparty criteria. Permitted investments are direct access deposit accounts, the giving of short term loans through brokers to counterparties. In addition surplus

funds may be left in the councils Telebank Investment Account or subject to individual £5m limits invested with other local authorities.

- 6.4** It is anticipated that during 2008/09 new investment guidance will be enacted by the Scottish Parliament. This guidance is expected to allow investments of periods longer than the current 364 day limit and to extend the range of investment options available to the council. At this time a further report will be made to Cabinet on the impact of any changes and resultant proposals to amend the council's approved Treasury Policies and Practices including permitted investments.

7. TREASURY MANAGEMENT PRUDENTIAL INDICATORS AND LIMITS ON ACTIVITY

- 7.1** The Council adopted the Code of Practice on Treasury Management on 2 May 2002, and as a result adopted a treasury management policy and practices statement. This adoption meets the requirements of the first of the treasury prudential indicators.

- 7.2** There are four further treasury prudential indicators. The purpose of these prudential indicators is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. 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. The use of investments greater than 364 days, although under review, is currently prohibited in Scotland, so this indicator is set as nil. Indicative rates are proposed that would be adopted if legislation is enabled in the forthcoming financial year.

The Council is asked to approve the following prudential indicators:

Interest rate Exposure: -

	2007/08 Upper Limit	2008/09 Upper Limit	2009/10 Upper Limit
Debt – variable rate interest	50%	50%	50%
Debt – fixed rate interest	100%	100%	100%

Maturity of Long Term External Debt: -

Maturity Period	Upper Limit	Lower Limit
Under 12 months	10%	0%
12 months to 2 years	10%	0%
2 years to 5 years	10%	0%
5 years to 10 years	25%	0%
10 years and above	100%	0%

Indicative Upper Limits on Sums Invested for more than 364 Days: -

Investment Period	Upper Limit
Under 12 months	100%
12 months to 2 years	40%
2 years to 5 years	10%
5 years to 10 years	5%
10 years and above	5%

8. PERFORMANCE INDICATORS

8.1 The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. Examples of performance indicators often used for the treasury function are:

- (a)** Investment Activity – Comparison of average interest rates achieved for investments compared to average 7 day rate available.
- (b)** Comparison of average rate of interest and expenses incurred during the financial year – “Pool Rate”.

The results of these indicators will be reported in the Treasury Annual Report for 2008/09

9 TREASURY ADVISORS

9.1 The council’s current 3 year agreement for the provision of treasury consultancy services ends in 2008/09. This service will be subjected to tender during the year.

10 FINANCIAL IMPLICATIONS

10.1 The financial implications of the proposed Treasury Management Strategy have been included within the respective estimates for the General Fund and the Housing Revenue Account for 2008/09.

11 POLICY/LEGAL IMPLICATIONS

11.1 The Treasury Management Policies and Practices will be updated as appropriate to reflect the above.

12 RECOMMENDATIONS

It is recommended that the Cabinet recommends that the Council: -

12.1 approve the Prudential Indicators set out in paragraph 7.2; and

12.2 otherwise, note the content of the report.

Alex McPhee
Executive Head of Finance & Asset Management

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25 March 2008

LIST OF BACKGROUND PAPERS

NIL

Any person who wishes any further information on this report should contact Lorna Service, Exchequer Manager, Tel 01563 576405