

EAST AYRSHIRE COUNCIL

CABINET - 31 MARCH 2010

TREASURY MANAGEMENT & INVESTMENT STRATEGY STATEMENT 2010/11 TO 2012/13

Report by Executive Head of Finance and Asset Management

1. PURPOSE

- 1.1 The purpose of the report is to seek Cabinet approval of the proposed Treasury Management Strategy Statement for 2010/11 which incorporates an annual Investment Strategy and sets out for consideration and approval the required Prudential Indicators. The report also seeks members' approval for the adoption of the revised Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice in the Public Services 2009.

2. BACKGROUND INFORMATION

The Local Government in Scotland Act 2003 includes a requirement for Councils to adopt and comply with the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities (The Code). The Code operates through the setting and monitoring of prudential Indicators and requires the production annually of a treasury management strategy. It is the duty of the Council to determine and keep under review the maximum amount which it can afford to allocate to capital expenditure.

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") requires local authorities to determine an annual Treasury Management Strategy Statement (TMSS) which should include the proposed Investment Strategy. Together, these cover the financing and investment strategy for the forthcoming financial year.

CIPFA has defined Treasury Management as:

"the management of the organisation's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

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: -

- Adoption of the CIPFA Code of Practice 2009
- The current treasury portfolio position
- The outlook and expected movement in interest rates
- The Council's borrowing and debt strategy
- Investment Strategy and Activity
- Prudential Indicators

3. CIPFA TREASURY MANAGEMENT CODE OF PRACTICE 2009

3.1 The Code of Practice was last revised in 2001 and adopted by the Council in May 2002. Following the collapse of the Icelandic Banks the Code was updated during 2009 which has resulted in a requirement that Cabinet approve 4 revised clauses in order to allow adoption of the Code of Practice.

3.2 The Code recommends that all public sector organisations adopt, as part of their standing orders, financial regulations, or other formal policy documents appropriate to their circumstances, the following clauses:

- (1) The Council will create and maintain, as the cornerstones for effective treasury management:
 - a Treasury Management Policy Statement, stating the policies, objectives and approach to risk management of its treasury management activities; and
 - suitable Treasury Management Practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities. The content of the policy statement (Section 6 of the Code) and TMP's (Section 7 of the Code) must follow the recommendations as required, and can only be subject to amendment where necessary to reflect the particular circumstances of the Council. Such amendments will not result in the Council materially deviating from the Code's key principles.
- (2) The Council will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of each financial year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.
- (3) The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Council's Cabinet, and for the execution and administration of treasury management decisions to the Executive Head of Finance and Asset Management, who will act in accordance with the organisation's policy statement and TMPs and CIPFA's Standard of Professional Practice on Treasury Management.

- (4) The Council nominates the Governance and Scrutiny Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

4. THE CURRENT TREASURY PORTFOLIO POSITION

- 4.1 The expected levels of external borrowing and investments for 2010/11 to 2012/13 are set out in the following table, together with the projected position at 31 March 2010.

	Projected as at 31 March 2010	Projected as at 31 March 2011	Projected as at 31 March 2012	Projected as at 31 March 2013
External Borrowing	£M	£M	£M	£M
Borrowing	202.627	232.376	276.778	304.782
Investments	-40.000	-20.000	-20.000	-20.000
Net External Debt	162.627	212.376	256.778	284.782

- 4.2. The overall level of borrowing is forecast to increase by £122.155M during the period 2010/11 to 2012/13 due to the additional capital expenditure planned over this period of time, whilst the level of investment will reduce by an estimated £20.000m due to movements in balances, reserves and general working capital. The prudential code requires that the capital programme is assessed for affordability and sustainability in the longer term. As a result the forecast level of borrowing, together with the projected cost of this will be included within the annual review of the investment programme.
- 4.3 The Council is required to prepare financial statements in accordance with International Financial Reporting Standards (IFRS) from 2009/10 onwards which has implications for the Capital Financing Requirement components on the Balance Sheet. It is expected that analysis of the Council's PPP scheme and also existing operating and finance leases against IFRS requirements will result in the related long term assets and liabilities being brought onto the Council's Balance Sheet. Where this is the case the estimates for the CFR and long term borrowing and liabilities will be revised appropriately.

5. OUTLOOK AND EXPECTED MOVEMENT IN INTEREST RATES

- 5.1 The detailed economic interest rate outlook provided by the Council's treasury advisor, Arlingclose Ltd, is attached at Appendix B. In summary the financial markets remain reasonably volatile as the structural changes necessary within economies and the banking system continue to evolve. This increased volatility, whilst increasing the underlying risk within the market does also provide additional opportunities for active treasury management. As a result the Council will continue to review its strategy periodically and, if needs be, realign it with evolving market conditions and expectations for future interest rates.

- 5.2** Short-dated gilt yields are forecast to be lower than medium- and long-dated gilt yields during the financial year. Despite additional gilt issuance to fund the UK government's support to the banking industry; short-dated gilts are expected to benefit from expectations of lower interest rates as the economy struggles through a recession. Yields for these maturities will fall as expectations for lower interest rates mount.
- 5.3** The differential between investment earnings and debt costs, despite long term borrowing rates being around historically low levels, remains acute and this is expected to remain a feature during 2010/11. The cost of carrying long term borrowing compared to temporary investment returns means that the appetite for new long term borrowing brings with it additional short-term costs. It is not surprising that the use of internal resources in lieu of borrowing has been the most cost effective means of financing capital expenditure but, at some stage, internal resources will become depleted and require topping up.
- 5.4** PWLB variable rates have fallen below 1%. They are expected to remain low as the Bank Rate is maintained at historically low levels to enable the struggling economy to emerge from the recession. Against a backdrop of interest rates remaining lower for longer and a continuation of the cost of carry backdrop, then a passive borrowing strategy i.e. borrow long term funds as they are required may remain appropriate. Equally, variable rate funds (that avoid the cost of carry) or EIP (equal instalments of principal) that mitigate the impact are both active considerations.

6. BORROWING AND DEBT STRATEGY 2010/11 TO 2012/13

- 6.1** The Council's estimated net borrowing requirement for 2010/11 to 2012/13 based upon the approved levels of capital investment, net of anticipated capital receipts, capital grants and contributions; capital funded from current revenue (CFCR) and annual debt repayment is summarised in the following table, along with the projected level of the Capital Financial Requirement (CFR) for each year.

	2009/10 Projected £M	2010/11 Estimated £M	2011/12 Estimated £M	2012/13 Estimated £M
Gross Capital Expenditure	39.060	55.939	71.221	49.627
Total Capital Financing	-17.829	-14.582	-15.517	-7.443
Net Capital Expenditure	21.231	41.357	55.704	42.184
Less Principal Repayments in Year	-9.711	-10.827	-12.143	-14.215
Estimated Borrowing Requirement	11.520	30.530	43.561	27.969
Add: Opening CFR at 1 April	220.549	232.069	262.599	306.160
Closing CFR at 31 March	232.069	262.599	306.160	334.129

- 6.2** The table at 6.1 identifies an underlying borrowing requirement for 2009/10 to 2012/13 of £113.581m. The Capital Finance Requirement (CFR) represents the cumulative capital expenditure of the local authority that has not yet been financed.

- 6.3** The Council has an integrated Treasury Management Strategy and manages its treasury position in accordance with the approved Treasury Strategy. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Council and not just those arising from capital spending reflected in the CFR. Borrowing is aggregated and the Council does not associate borrowing with particular items or types of expenditure.
- 6.4** Capital expenditure not financed from Capital Grants, Revenue or Reserves will produce an increase in the CFR equal to the underlying need to borrow shown above.
- 6.5** As the CFR represents the level of borrowing for capital purposes and given that revenue expenditure cannot be financed from borrowing, net physical external borrowing should not exceed the CFR other than for short term cash flow requirements. It is permissible under the Prudential Code to borrow in advance of need up to the level of the estimated CFR over the term of the Prudential Indicators. Where this takes place the cash will form part of its invested sums until the related capital expenditure is incurred.
- 6.6** This being the case net borrowing should not exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years other than in the short term due to cash flow requirements.
- 6.7** Physical external borrowing may be greater or less than the CFR at a fixed period in time, but in accordance with the Prudential Code, the Council will ensure that net external borrowing does not, except in the short term, exceed the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years.
- 6.8** Any decision to borrow at low, variable rates of interest will only be taken after considering the absolute level of longer term interest rate equivalents and the extent of variable rate earnings on the Council's investment balances. When longer term rates move below the cost of variable rate borrowing any strategic exposure to variable interest rates will be reviewed and, if appropriate, reduced.
- 6.9** The PWLB remains the preferred source of borrowing given the transparency and control that its facilities continue to provide.
- 6.10** The Council has £66.6m loans which are LOBO loans (Lender Option Borrower Option). In the event that the lender exercises the option to change the rate or terms of the loan at predetermined periods in the life of a loan, the Council will consider the terms being provided and also repayment of the loan without penalty. The Council may utilise cash resources for repayment or may consider replacing the loan(s) by borrowing from the PWLB. In these circumstances a financial options appraisal will be undertaken to establish and support the decision taken.

6.11 The Prudential Code requires the Council to ensure that its total borrowing net of any investments, does not, except over the short term, exceed the total of the Capital Finance Requirement (CFR) in the preceding year plus the estimates of additional CFR for the current and 2 subsequent years. This provides flexibility for additional borrowing but guards against any borrowing being undertaken to finance revenue expenditure.

6.12 The projected position of CFR compared to external debt levels is shown in the following table and it can be seen that the estimated debt levels are within the forecast CFR in each year, demonstrating that borrowing is only planned to finance capital activities.

	31/03/2010 Estimate £m	31/03/2011 Estimate £m	31/03/2012 Estimate £m	31/03/2013 Estimate £m
Capital Financing Requirement Comparator	306.160	334.129	333.926	327.470
Net External Debt	162.627	212.376	256.778	284.782

6.13 It can therefore be seen that the estimated level of debt in each of the years is well within the forecast CFR which demonstrates that borrowing will only be undertaken for capital purposes.

6.14 The Council's strategy is to maintain maximum control over its borrowing activities as well as flexibility on its loans portfolio. Capital expenditure levels, market conditions and interest rate levels will be monitored during the year in order to minimise borrowing costs over the medium to longer term. A prudent and pragmatic approach to borrowing will be maintained to minimise borrowing costs without compromising the longer-term stability of the portfolio, consistent with the Council's Prudential Indicators.

6.15 In conjunction with advice from its treasury advisor, Arlingclose Ltd, the Council will keep under review the options it has in borrowing from the PWLB, the market and other sources identified up to the available capacity within its CFR and Affordable Borrowing Limit (defined by CIPFA as the Authorised Limit).

7. DEBT RESCHEDULING

7.1 The Council will continue to maintain a flexible policy for debt rescheduling. It is expected that the volatility in the financial markets may provide opportunities for rescheduling debt from time to time. The rationale for rescheduling would be one or more of the following:

- Savings in interest costs with minimal risk to the Council
- Balancing the volatility profile (i.e. the ratio of fixed to variable rate debt) of the debt portfolio
- Amending the profile of maturing debt to reduce any inherent refinancing risks.

- 7.2** Any rescheduling activity will be undertaken within the Council's treasury management policy and strategy. The Council will agree in advance with Arlingclose the strategy and framework within which debt will be repaid/rescheduled if opportunities arise. Thereafter the debt portfolio will be monitored against equivalent interest rates and available refinancing options on a regular basis. As opportunities arise, they will be identified by Arlingclose and discussed with the Executive Head of Finance and Asset Management.
- 7.3** All rescheduling will comply with the accounting requirements of the Local Authority SORP and Statutory requirements of the Scottish Government's Guidance on Local Authority Accounting Proper Accounting Practices dated 30 March 2007. All borrowing and debt rescheduling will be reported to Members in the quarterly treasury report in line with the timetable set out later in this report.

8. INVESTMENT STRATEGY

- 8.1** In order to comply with the guidance expected to be issued shortly by Scottish Government, together with the existing CIPFA Code, the Council's general policy objective will be to ensure that all surplus funds are invested in a prudent manner. In practice this requires that the accepted order for investment priorities are:
- security of the invested capital;
 - liquidity of the invested capital;
 - an optimum yield which is commensurate with security and liquidity.
- 8.2** The CIPFA Prudential Code is clear that local authorities must not borrow more than or in advance of needs purely in order to profit from the investment of the additional sums borrowed. Borrowing in advance is defined as any borrowing undertaken by the local authority which will result in the total external debt of the local authority exceeding the capital financing requirement (CFR) for the following 12 month period.
- 8.3** Any borrowing decision will therefore require to be supported by a separate evaluation in order that there is no breach of the prudential code in this respect.
- 8.4** Investments are categorised as Permitted investments based on the criteria in the Scottish Government's Investment Guidance. Potential instruments for use within its investment strategy are set out in Appendix C.
- 8.5** The credit crisis has refocused attention on the priority of security of capital monies invested. The Council will continue to maintain a counterparty list based on its agreed criteria and will monitor and update the credit standing of the institutions on a regular basis. This assessment will include credit ratings and other alternative assessments of credit strength as outlined in paragraph 9.5.

- 8.6** The UK Bank Rate has been maintained at 0.5% since March 2009. It is anticipated that short-term money market rates are likely to remain at very low levels which will have a significant impact on investment income. The Council's strategy must however be geared towards this development whilst adhering to the overriding principle of security of invested monies.
- 8.7** The Executive Head of Finance and Asset Management will undertake the most appropriate form of investment in keeping with the overall investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on the core investment portfolio will be reported to Cabinet.

9. INVESTMENT ACTIVITY

- 9.1** The Council's shorter term cash flow investments are made with reference to the outlook for the UK Bank Rate and money market rates. In any period of significant stress in the markets, the default position is for investments to be made with the Debt Management Office, which is a Central Government Body, if they cannot be placed with any other approved counterparty.
- 9.2** Currently the Council has restricted the scope of available investment instruments to the following:
- The Debt Management Agency Deposit Facility (DMADF): -The rates of interest offered by the DMADF are below equivalent money market rates. The additional security from investing with this central government agency is however viewed as an acceptable trade-off.
 - Business reserve accounts and term deposits. *These have been primarily restricted to UK institutions that are rated at least A+ long term (or equivalent), and which have access to the UK Government's 2008 Credit Guarantee Scheme (CGS)*
 - Deposits with other local authorities
 - AAA-rated Money Market Funds with a Constant Net Asset Value (CNAV). *(No use has as yet been made of these funds).*
 - Bonds issued by Multilateral Development Banks. *(No use has been made of these facilities to date.)*
- 9.4** Conditions in the financial sector have begun to show signs of improvement, albeit with substantial intervention by government authorities. In order to diversify the counterparty list, the use of comparable non-UK Banks for investments is now considered appropriate.
- 9.5** The approved list of counterparties, who meet the rating criteria, has previously been reported to Cabinet. The Council's treasury advisors Arlingclose Ltd have advised that the sovereign states whose banks could now be included are Australia, Canada, Finland, France, Germany, Netherlands, Spain, Switzerland and the US. These countries and the

Banks within them (see Appendix D), have been selected after analysis and careful monitoring of:

- Credit Ratings (minimum long-term A+)
- Credit Default Swaps
- GDP; Net Debt as a Percentage of GDP
- Sovereign Support Mechanisms/potential support from a well-resourced parent institution
- Share Price

9.6 Consideration has also taken of information on corporate developments and market sentiment towards the counterparties. The Executive Head of Finance and Asset Management, together with Arlingclose Ltd, will continue to analyse and monitor these indicators and credit developments on a regular basis and respond as necessary to ensure security of the capital sums invested.

9.7 Notwithstanding the signs of improvement within the financial markets these still remain in a heightened state of sensitivity to risk. This modest expansion of the counterparty list is an incremental step. In order to ensure that the requirements of the revised CIPFA Treasury Management Code are met, the Council will continue to focus on a range of indicators in assessing counterparties, as set out above.

9.8 Investments will continue to be restricted to those counterparties covered by the UK Government's 2008 Credit Guarantee Scheme (CGS) for the immediate future. While the CGS does not in itself guarantee any term deposits or monies invested in call accounts the eligible institutions are deemed systematically important to the stability of the UK financial system. The additional flexibility derived from adding these Non UK banks will allow the Executive Head of Finance and Asset Management to consider further diversification of the portfolio following careful consideration of the risks associated.

9.9 Proposed monetary and time limits for Specified Investments and counterparties are set out in Appendix D to this report.

9.10 To protect against a prolonged period of low interest rates, 1-year deposits and longer-term secure investments will be actively considered within the limits set out for Non-Specified Investments. The longer-term investments will be likely to include:

- **Supranational bonds (bonds issued by multilateral development banks):** The joint and individual pan-European government guarantees in place on these bonds provide security of the principal invested. Even at the lower yields likely to be in force, the return on these bonds will provide certainty of income against an outlook of low official interest rates.

- **UK government guaranteed bonds and debt instruments issued by banks/building societies:** The UK Government's 2008 Credit Guarantee Scheme permits specific UK institutions to issue short-dated bonds with an explicit government guarantee. The bonds are issued at a margin over the underlying gilt and would be a secure longer-term investment option.

9.11 All investment activity will comply with the accounting requirements of the local authority SORP.

10. PRUDENTIAL INDICATORS

10.1 The Local Government in Scotland Act 2003 includes a requirement for Councils to comply with the Prudential Code for Capital Finance in Local Authorities (the Code). The Code sets out a range of indicators covering both capital investment and treasury management. Prudential Indicators require to be set in advance of the forthcoming financial year and are intended to support strategic planning decisions in relation to capital investment.

10.2 The key objective of the Prudential Code is to ensure that the capital investment plans of the Council are affordable, prudent and sustainable and that they support local strategic planning. This report relates specifically to the prudential indicators themselves however capital investment is also supported by a number of other activities within the Council including asset management planning, option appraisal, service planning and project management all of which are elements of good practice in this area.

10.3 The required indicators, together with a summary of their purpose in supporting decision making are attached to this report as Appendix A.

11. FREQUENCY OF TREASURY MANAGEMENT REPORTING

11.1 It is proposed that the frequency and type of reporting to Cabinet on treasury management activity and performance during 2010/11 will be:

- (i) a quarterly and year end review against the strategy approved for the year.
- (ii) The Council will produce an outturn report on its treasury activity no later than 30th September after the financial year end.
- (iii) Reports will, in line with the existing procedure for finance and service strategy reports also be presented to the Governance and Scrutiny Committee.

12. ELECTED MEMBER TRAINING

12.1 CIPFA's revised Treasury Management Code requires the Chief Financial Officer to ensure that all elected members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

12.2 In this respect is intended that appropriate training will be provided for all elected members during the first quarter of 2010/11 and the Executive Head of Finance and Asset Management, will in consultation with the Head of Democratic Services make the necessary arrangements.

13. FINANCIAL IMPLICATIONS

13.1 The financial implications of the proposed Treasury Management and Investment Strategy Statement have been included within the respective estimates for the General Fund and Housing Revenue Account for 2010/11 onwards.

14. RISK IMPLICATIONS

14.1 The CIPFA Code of Practice requires the Council to put in place Policies and Practices which assist in the delivery of the service and help reduce the overall risk exposure within the activity.

15. LEGAL AND POLICY IMPLICATIONS

15.1 The Treasury Management Policies and Practices will be updated as necessary to reflect the content of this report

16. RECOMMENDATIONS

16.1 It is recommended that Cabinet

- (i) approves the Treasury Management and Investment Strategy Statement 2010/11 – 2012/13
- (ii) approves the adoption of the CIPFA Treasury Management Code of Practice 2009
- (iii) approve the Prudential Indicators as set out in Appendix A
- (iv) notes the proposed changes to the counterparty list as set out in paragraph 8.4 and 8.5.
- (v) otherwise notes the content of the report.

Alex McPhee
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RB
9 March 2010

LIST OF BACKGROUND PAPERS

- Treasury Management Annual Strategy Report 2009/10 – Cabinet 18 March 2009
- Treasury Management Annual Report 2008/09 and Update on 2009/10 Strategy – Cabinet 21 October 2009
- CIPFA Code of Practice for Treasury Management in the Public Services 2009

Any person wishing further information on this report should contact Robin Baker, Financial Controller, Tel: 01563 576331

PRUDENTIAL INDICATORS 2010/11 TO 2012/13

1 Background:

There is a statutory requirement for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators. It should be noted that CIPFA issued a revised Code in November 2009.

2. Net Borrowing and the Capital Financing Requirement:

This is a key indicator of prudence. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that the net external borrowing does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

The Executive Head of Finance and Asset Management reports that the authority had no difficulty meeting this requirement in 2009/10, nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

3. Estimates of Capital Expenditure:

3.1 This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax and in the case of the HRA, housing rent levels.

Capital Expenditure	2009/10 Estimate £m	2009/10 Projected £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
Non-HRA	13.504	24.963	41.544	58.342	38.979
HRA	15.616	14.097	14.395	12.879	10.648
Total	29.120	39.060	55.939	71.221	49.627
Capital Financing					
Capital Receipts	4.888	2.365	2.202	1.730	1.782
Grants	8.288	7.909	4.219	5.626	0.000
CFCR	7.052	6.355	5.661	5.661	5.661
Capital Fund	1.773	1.200	2.500	2.500	0.000
Supported Borrowing	7.130	7.130	7.130	7.130	7.130
Prudential Borrowing	13.904	14.101	34.227	48.574	35.054
Total	29.120	39.060	55.939	71.221	49.627

4. Ratio of Financing Costs to Net Revenue Stream:

4.1 This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet borrowing costs.

4.2 The ratio is based on costs net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2009/10 Estimate £m	2009/10 Projected £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
Non-HRA	6.35%	6.28%	6.51%	6.92%	7.32%
HRA	14.33%	13.80%	15.47%	16.44%	16.93%

5. Capital Financing Requirement:

5.1 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and its financing. It is an aggregation of the amounts shown for Fixed and Intangible assets, the Revaluation Reserve, the Capital Adjustment Account, Government Grants Deferred and any other balances treated as capital expenditure.

Capital Financing Requirement	2009/10 Estimate £m	2009/10 Projected £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
Non-HRA	163.901	163.695	189.779	229.987	256.662
HRA	67.799	68.104	72.820	76.174	77.468
Total CFR	231.700	232.069	262.599	306.160	334.129

6. Actual External Debt:

6.1 This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

Actual External Debt as at 31/03/2009	£m
Borrowing	206.410
Other Long-term Liabilities	0.075
Total	206.485

7. Incremental Impact of Capital Investment Decisions:

7.1 This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax and Housing Rent levels. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

Incremental Impact of Capital Investment Decisions	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
Increase in Band D Council Tax	-	19.30	20.87
Increase in Average Weekly Housing Rents	£0.10	£0.33	£0.33

The Council approved a Council Tax in line with the 2009/10 level at its meeting on 12 February 2010. As such there will be no impact on the council tax arising from capital investment decisions in 2010/11. Indicative levels for 2011/12 and 2012/13 are shown for information only and will continue to be reviewed annually.

The movement shown in relation to the Housing Rents is due to the anticipated impact of the affordable housing programme being added to the previously agreed 5 year capital programme.

8. Authorised Limit and Operational Boundary for External Debt:

8.1 The Council has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy and practice. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Council and not just those arising from capital spending reflected in the CFR.

8.2 The **Authorised Limit** sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities).

This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Council's existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.

8.3 The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unexpected cash movements.

8.4 It is a statutory duty, under the Local Government in Scotland Act 2003 and supporting regulations, for the Council to decide and to keep under review how much it can afford to allocate to capital expenditure and how much it can afford to borrow. This is referred to as the Authorised Borrowing Limit.

8.5 The **Operational Boundary** links directly to the Council's estimates of the CFR and estimates of other cash flow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but

not worst case scenario but without the additional headroom included within the Authorised Limit.

8.6 The Executive Head of Finance and Asset Management has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the next meeting of the Cabinet.

	2009/10 Estimate £m	2009/10 Projected £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
Authorised Limit for External Debt	314.000	302.651	351.159	365.510	342.396
Operational Boundary for External Debt	299.000	288.239	334.437	348.105	326.092

9. Adoption of the CIPFA Treasury Management Code:

9.1 This indicator demonstrates that the Council has adopted the principles of best practice.

No. 8	Adoption of the CIPFA Code of Practice in Treasury Management
	The Council approved the adoption of the CIPFA Treasury Management Code at its meeting on 2 May 2002, and this report recommend adoption of the 2009 revised Code.

10. Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure:

10.1 These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. This Council calculates these limits on net principal outstanding sums, (i.e. fixed rate debt net of fixed rate investments // net interest paid (i.e. interest paid on fixed rate debt net of interest received on fixed rate investments)

10.2 The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises which could adversely impact on the revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments

	2009/10 Projected £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
Upper Limit for Fixed Interest Rate Exposure	150%	150%	150%	150%
Upper Limit for Variable Interest Rate Exposure	40%	40%	40%	40%
EXAMPLE				
Total Debt	202.627	231.414	285.883	310.444
Total Investments	-40.000	-20.000	-20.000	-20.000
Total Net Debt	162.627	211.414	265.883	290.444
Represented By				
Fixed Debt	135.217	164.814	219.283	243.844
Fixed Investments	0.000	0.000	0.000	0.000
Fixed Net Debt	135.217	164.814	219.283	243.844
Variable Debt	67.410	66.600	66.600	66.600
Variable Investments	-40.000	-20.000	-20.000	-20.000
Total Variable Debt	27.410	46.600	46.600	46.600
Exposure – Fixed Debt/Total Net Debt	83.15%	77.96%	82.47%	83.96%
Exposure – Variable Net Debt/Total Net Debt	16.85%	22.04%	17.53%	16.04%

10.3 The limits above provide the necessary flexibility within which decisions will be made for drawing down new loans on a fixed or variable rate basis; the decisions will ultimately be determined by expectations of anticipated interest rate movements as set out in the Council's treasury management strategy.

11. Maturity Structure of Fixed Rate borrowing:

11.1 This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

11.2 It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

Maturity structure of fixed rate borrowing	Lower Limit %	Upper Limit %
under 12 months	0%	10%
12 months and within 24 months	0%	20%
24 months and within 5 years	0%	50%
5 years and within 10 years	0%	50%
10 years and within 20 years	0%	50%
20 years and within 30 years	0%	60%
30 years and within 40 years	0%	70%
40 years and within 50 years	0%	80%
50 years and above	0%	90%

12. Upper Limit for total principal sums invested over 364 days:

12.1 These limits are set to reduce the need to redeem debt prematurely, which could result in loss of interest and/or penalty charges. The use of investments greater than 364 days is not yet permitted in Scotland although it is expected that the Scottish Government will publish revised investment guidance during financial year 2010/11. As a result the internal limits proposed are at this stage only

Upper Limit for total principal sums invested over 364 days	2009/10 Actual £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
Under 12 months	100%	100%	100%	100%
12 months to 2 years	40%	40%	40%	40%
2 years to 5 years	10%	10%	10%	10%
5 years to 10 years	5%	5%	5%	5%
10 years and above	5%	5%	5%	5%

Arlingclose Economic and Interest Rate Forecast

Interest Rate Forecast:

	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
Official Bank Rate													
Upside risk			+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	0.50	0.50	0.50	1.00	1.50	2.00	2.50	3.00	3.00	3.00	3.00	3.00	3.00
Downside risk				-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
1-yr LIBID													
Upside risk			+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	1.25	1.25	1.50	1.75	2.25	3.00	3.50	4.00	4.00	4.00	4.00	4.00	4.00
Downside risk				-0.25	-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
5-yr gilt													
Upside risk	+0.25	+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	2.70	2.80	2.90	3.00	3.25	3.50	3.75	4.00	4.25	4.25	4.25	4.25	4.25
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
10-yr gilt													
Upside risk		+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.50	+0.50	+0.50	+0.50
Central case	3.75	3.75	4.00	4.00	4.25	4.25	4.50	4.50	4.75	5.00	5.00	5.00	5.00
Downside risk		-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
20-yr gilt													
Upside risk	+0.25	+0.50	+0.50	+0.50	+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.50	+0.50	+0.50
Central case	4.25	4.50	4.75	4.75	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
50-yr gilt													
Upside risk	+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	4.25	4.50	4.50	4.50	4.75	4.75	4.75	4.75	4.75	5.00	5.00	4.75	4.75
Downside risk		-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25

Economic Forecast:

- The recovery in economic growth is likely to be slow and uneven, if viewed graphically this would tend to appear as a “W” than “V” shaped plot. It is anticipated that The Bank of England will stick to its lower-for-longer stance on base rates.
- Gilt yields will remain volatile; yields have been compressed by Quantitative Easing (QE) and will rise once QE tapers off and if government debt remains at record high levels.
- The path of the base rate has been downgraded to reflect the fragile state of the recovering economy and the severe fiscal correction that is anticipated to follow the General Election, dampening aggregate demand and cutting household cashflow. Expectations of central bank exit strategies and their timing will increase volatility in sovereign bond yields and equities.

- There are significant threats to the forecast from potential downgrades to sovereign ratings and/or political instability.

Underlying assumptions:

- The Bank of England's Quantitative Easing (QE) program which injected £200bn to insure against the downside risks to growth and stimulate the economy officially ends 26 January. We estimate that QE has depressed gilt yields by around 0.7%.
- The Bank forecasts GDP to grow by 4% in 2011 but concedes growth could be impeded by corporate and consumer balance sheet adjustments, restrictions in bank credit and consumers' cautious spending behaviour. This is an optimistic forecast in our view; evidence of recovery is scant with weak real economic data and rising unemployment. Q4 2009 grew by just 0.1%.
- Looming bank regulation and liquidity and capital requirements will curb bank lending activity. The Bank retains the option to reduce the rate on commercial banks' deposits to encourage them to lend. But FSA regulations will force banks to buy more Gilts which could help slow the rise in yields in 2010/11.
- The employment outlook remains uncertain. Pay freezes, short hours, job cuts and a migration toward part time employment will continue into 2010 keeping the headline unemployment number down.
- Inflation is not an immediate worry for the Bank which forecasts CPI to rise due to higher commodity prices and VAT reverting to 17.5%. Commodity prices and VAT will push inflation over 3% prompting a letter from the Bank's Governor to the Chancellor in Q1 2010.
- The UK fiscal deficit remains acute. Cuts in public spending and tax increases are now inevitable and more likely to be pushed through in 2010 by a new government with a clear majority; however a hung parliament cannot be ruled out and would be potentially disruptive to financial markets.
- The net supply of gilts will rise to unprecedented levels in 2010. Failure to articulate and deliver on an urgent and credible plan to lower government borrowing to sustainable levels over the medium term will be negative for gilts.
- The Federal Reserve Chairman Bernanke's diagnosis of a weak U.S. economy and labour market signal that the Fed's "extended period" of low rates may get even longer. The outlook for the Eurozone is more optimistic but the European Central Bank will only increase rates after a durable upturn in growth.

Permitted Investments

Permitted Investments identified for use by the Council

Local Authorities are required to draft their Investment Strategy in a way that identifies the different types of treasury risk that their permitted investments are exposed to – credit or security risk (of default), liquidity risk (risks associated with committing funds to longer term investments) and market risk (effect of market prices on investment value). The Strategy should describe the controls in place for limiting those risks.

Local Authorities are required to list all types of investment that they will permit in the financial year in their strategy. These will be known as permitted investments. Local authorities should set a limit to the amounts that may be held in such investments at any time in the year. The limit may be a sum of money or a percentage of total investments, or both. Local authorities may leave some types of investment as unlimited but the reasons for doing so must be set out in the Strategy and should be consistent with the risk assessment undertaken.

Permitted Investments identified for the Council's use are:

- Deposits in the DMO's Debt Management Account Deposit Facility
- Deposits with UK local authorities
- Deposits with banks and building societies
- *Certificates of deposit with banks and building societies
- *Gilts : (bonds issued by the UK government)
- *Bonds issued by multilateral development banks
- AAA-rated Money Market Funds with a Constant Net Asset Value (Constant NAV)

For credit rated counterparties, the minimum criteria will be the short-term / long-term ratings assigned by various agencies which may include Moody's Investors Services, Standard & Poor's, Fitch Ratings.

Long-term minimum: A1 (Moody's) or A+ (S&P) or A+ (Fitch)

Short-term minimum: P-1 (Moody's) or A-1 (S&P) or F1 (Fitch).

The Council will also take into account information supplied by Arlingclose Ltd, as appointed Treasury Management advisors, on corporate developments of and market sentiment towards investment counterparties.

EAST AYRSHIRE COUNCIL

COUNTERPARTY INVESTMENT LIST 2010/11

Instrument	Country	Counterparty	Maximum Limit of Investments %/£m	Maximum Maturity Limit	Treasury Risk Exposure	Controls to Mitigate Treasury Risks
Term Deposits	UK	DMADF, DMO	No limit	364 days	liquidity risk, market risk	Maturity Limit 364 days
Term Deposits/ Call Accounts	UK	Other UK Local Authorities	20%/£10m	364 days	credit risk, security risk,	Access to UK Credit Guarantee Scheme
Term Deposits/ Call Accounts	UK	Abbey/ Santander	20%/ £10m	364 days	credit risk, security risk,	Access to UK Credit Guarantee Scheme
Term Deposits/ Call Accounts	UK	Bank of Scotland/ Lloyds	20%/ £10m	364 days	credit risk, security risk,	Access to UK Credit Guarantee Scheme
Term Deposits/ Call Accounts	UK	Barclays	20%/ £10m	364 days	credit risk, security risk,	Access to UK Credit Guarantee Scheme
Term Deposits/ Call Accounts	UK	Clydesdale	20%/ £10m	364 days	credit risk, security risk,	Access to UK Credit Guarantee Scheme
Term Deposits/ Call Accounts	UK	HSBC	20%/ £10m	364 days	credit risk, security risk,	Access to UK Credit Guarantee Scheme
Term Deposits/ Call Accounts	UK	Nationwide	20%/ £10m	364 days	credit risk, security risk,	Access to UK Credit Guarantee Scheme
Term Deposits/ Call Accounts	UK	Royal Bank of Scotland	20%/ £10m	364 days	credit risk, security risk,	Access to UK Credit Guarantee Scheme
Term Deposits/ Call Accounts	Australia	Australia and NZ Banking Group	£5m (Country limit 25%)	182 days	credit risk, security risk,	Ongoing Credit monitoring
Term Deposits/ Call Accounts	Australia	Commonwealth Bank of	£5m (Country limit	182 days	credit risk, security risk,	Ongoing Credit monitoring

		Australia	25%)			
Term Deposits/ Call Accounts	Australia	National Australia Bank Ltd	£5m (Country limit 25%)	182 days	credit risk, security risk,	Ongoing Credit monitoring
Term Deposits/ Call Accounts	Australia	Westpac Banking Corp	£5m (Country limit 25%)	182 days	credit risk, security risk,	Ongoing Credit monitoring
Term Deposits/ Call Accounts	Canada	Bank of Montreal	£5m (Country limit 25%)	182 days	credit risk, security risk,	Ongoing Credit monitoring
Term Deposits/ Call Accounts	Canada	Bank of Nova Scotia	£5m (Country limit 25%)	182 days	credit risk, security risk,	Ongoing Credit monitoring
Term Deposits/ Call Accounts	Canada	Canadian Imperial Bank of Commerce	£5m (Country limit 25%)	182 days	credit risk, security risk,	Ongoing Credit monitoring
Term Deposits/ Call Accounts	Canada	Royal Bank of Canada	£5m (Country limit 25%)	182 days	credit risk, security risk,	Ongoing Credit monitoring
Term Deposits/ Call Accounts	Canada	Toronto-Dominion Bank	£5m (Country limit 25%)	182 days	credit risk, security risk,	Ongoing Credit monitoring
Term Deposits/ Call Accounts	Finland	Nordea Bank Finland	£5m (Country limit 25%)	182 days	credit risk, security risk,	Ongoing Credit monitoring
Term Deposits/ Call Accounts	France	BNP Paribas	£5m (Country limit 25%)	182 days	credit risk, security risk,	Ongoing Credit monitoring
Term Deposits/ Call Accounts	France	Calyon (Credit Agricole Group)	£5m (Country limit 25%)	182 days	credit risk, security risk,	Ongoing Credit monitoring
Term Deposits/ Call Accounts	France	Credit Agricole SA	£5m (Country limit 25%)	182 days	credit risk, security risk,	Ongoing Credit monitoring
Term Deposits/ Call Accounts	Germany	Deutsche Bank AG	£5m (Country limit 25%)	182 days	credit risk, security risk,	Ongoing Credit monitoring

Term Deposits/ Call Accounts	Netherlands	Rabobank	£5m (Country limit 25%)	182 days	credit risk, security risk,	Ongoing Credit monitoring
Term Deposits/ Call Accounts	Spain	Banco Bilbao Vizcaya Argentaria	£5m (Country limit 25%)	182 days	credit risk, security risk,	Ongoing Credit monitoring
Term Deposits/ Call Accounts	Spain	Banco Santander SA	£5m (Country limit 25%)	182 days	credit risk, security risk,	Ongoing Credit monitoring
Term Deposits/ Call Accounts	Switzerland	Credit Suisse	£5m (Country limit 25%)	182 days	credit risk, security risk,	Ongoing Credit monitoring
Term Deposits/ Call Accounts	US	JP Morgan	£5m (Country limit 25%)	182 days	credit risk, security risk,	Ongoing Credit monitoring
Gilts	UK	DMO	No limit	364 days	liquidity risk, market risk	Maturity Limit 364 days
Bonds	EU	European Investment Bank/Council of Europe etc.	No limit	364 days	liquidity risk, market risk	Maturity Limit 364 days
AAA rated Money Market Funds	UK/ Ireland/ Luxembourg	CNAV MMFs	20% / £10m	364 days	market risk	Ongoing monitoring in conjunction with Arlingclose
Other MMFs and CIS	UK	Collective Investment Schemes	20% / £10m	364 days	market risk	Ongoing monitoring in conjunction with Arlingclose
Certificates of Deposit				364 days		

Non-UK Banks - restricted to a maximum exposure of 25% per country. This means that effectively all investments can be made with non-UK institutions, but it limits the risk of over-exposure to any one country.