

EAST AYRSHIRE COUNCIL

GOVERNANCE AND SCRUTINY COMMITTEE– 27 AUGUST 2010

TREASURY MANAGEMENT ANNUAL REPORT FOR 2009/10 AND UPDATE ON 2010/11 STRATEGY POSITION

Report by Executive Director of Finance and Corporate Support

1 PURPOSE OF REPORT

- 1.1** The purpose of the report is to provide Members of the Governance and Scrutiny Committee with a summary of the treasury activity for the financial year ended 31 March 2010 and an update on the Treasury Management strategy for 2010/11.

2 BACKGROUND INFORMATION

- 2.1** Treasury Management can be defined as the oversight and control of the Council's cash flows, its banking activity, the interaction with the financial and capital markets through daily borrowing and investment activity and the control of the associated risks, together with the pursuit of optimal performance consistent with these risks.
- 2.2** The Council's treasury management activities are regulated by professional codes of practice, statute and regulatory guidance. The Council has adopted the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Services Code of Practice 2009 (The Code of Practice). This places importance on the overall management of risks, including liquidity; interest rate; credit and counterparty risk and requires that authorities have in place robust treasury policies and practices to address these.
- 2.3** The unique and very challenging economic position of 2008/09 continued during the financial year 2009/10, with only limited economic stability and recovery being evidenced in the latter part of it. As such the main concerns from a treasury perspective remained diminishing investment returns due to low rates of interest coupled with continued uncertainty around the level of counterparty risk.
- 2.4** The Code of Practice requires the Executive Director of Finance and Corporate Support to provide an annual report to Members covering the Council's activities and performance in respect of Treasury Management. This report sets out information in relation to the following:
- Statutory and regulatory framework for treasury management
 - Treasury risks
 - Debt and borrowing activity
 - Investment activity and strategy
 - Prudential and local performance Indicators

3 STATUTORY AND REGULATORY FRAMEWORK

- 3.1** The Council, through the adoption of the CIPFA Code of Practice places strong importance on the overall management of risks, including liquidity; interest rate and credit and counterparty risk. The Code requires that the Council has in place robust treasury policies and practices to address these. As such the Director of Finance and Corporate Support maintains a Policies and Practices Manual which is published as Accounting Policy Bulletin No.8.
- 3.2** The Local Government in Scotland Act 2003 (the Act) provides the statutory authority to undertake borrowing and investment activity together with prescribing controls and limits for this. The Act permits the Scottish Ministers to impose limits either on the Council or at a national level on all local authorities restricting the amount of borrowing which may be undertaken. No restrictions were made in 2009/10 or indeed in previous years.
- 3.3** Statutory Instrument (SSI) 29 2004, requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities, and therefore to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services.
- 3.4** The Local Government Investments (Scotland) Regulations 2010 permit local authorities to make investments subject to gaining the consent of Scottish Ministers. This allows the Council to determine what investments to make both in terms of the type and the duration. Where it is intended to hold longer term investments (greater than 364 days) the risks associated with this and the objectives for doing so require to be set out in the investment strategy.
- 3.5** The Code of Practice was revised in November 2009. A key change within the revised guidance was that the Audit Committee, or equivalent Committee charged with this responsibility within each Council, be responsible for ensuring effective scrutiny of the treasury management practices and activities. Council adopted this code on 31 March 2010 and operates its treasury management duties in compliance with the Code and the regulatory framework set out in paragraphs 3.1 to 3.4 above.

4 TREASURY RISK

- 4.1** The effective management of risk is the primary objective within the treasury management strategy and operational policies and practices. Whilst obtaining an optimum performance, whether investing surplus funds or borrowing to fund capital expenditure, is an important consideration it will be carried out by reference to the principles set out in the treasury management strategy.
- 4.1** Security and liquidity remain the overriding factors which will determine investment and borrowing activity with yield or cost only being considered once they have been satisfied. In doing so the following risk factors are key to the formulation and implementation of the approach, and the controls identified are considered effective at mitigating the associated risk:
- 4.1.1** **Credit and Counterparty risk** – *“The risk of failure by a counterparty to meet its contractual obligations to the organisation under an investment, borrowing, capital, project or partnership financing, particularly as a result of the counterparty’s diminished creditworthiness, and the resulting detrimental effect on the organisation’s capital or current (revenue) resources”*

- An approved counterparty list is maintained which is subject to regular review and update by the Council's treasury advisors Arlingclose Ltd.
- Limits over the level of investment, both monetary and time have been set and agreed for all permitted investments.

4.1.2 Liquidity Risk – *“The risk that cash will not be available when it is needed, that ineffective management of liquidity creates additional unbudgeted costs, and that the organisation’s business/service objectives will be thereby compromised”*

- Short and medium term cash flow forecasts are in place to monitor and forecast peaks in demand with the investment portfolio profiled to allow immediate access to sufficient levels of funds to cover any shortfall.
- Overdraft facilities are maintained with the Council's appointed banker – Clydesdale Bank PLC
- Capacity for short term temporary borrowing to smooth any emergency cash flow deficits.

4.1.3 Interest Rate Risk – *“The risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the organisation’s finances, against which the organisation has failed to protect itself adequately”*

- Prudential indicators require limits to be agreed to reduce exposure to interest rate movements – no more than 40% of the debt portfolio can be at variable rates of interest whilst limits are also in place to regulate the percentage of debt maturing in any 1 year.
- Limits have been agreed in relation to maximum investment periods and the percentage of the portfolio that can be placed in excess of 1 year.

4.1.4 Refinancing Risk – *“The risk that maturing borrowings, capital, project or partnership financings cannot be refinanced on terms that reflect the provisions made by the organisation for those refinancing, both capital and current (revenue), and/or that the terms are inconsistent with prevailing market conditions at the time”*

- Upper limits are in place to ensure the level of debt maturing in any 1 year does not impact on overall treasury position.
- Limits are agreed to limit ratio of fixed to variable debt in the portfolio
- Sound diversification policy in respect of counterparties limits investment risk

4.1.5 Legal Risk - *“The risk that the organisation itself, or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, and that the organisation suffers losses accordingly”*

- Adherence to the current statutory framework
- Compliance with the CIPFA Code of Practice
- Quarterly reporting to Governance and Scrutiny Committee
- Any matter of legal uncertainty is be referred to the Solicitor to the Council

4.1.6 Market Risk – *“The risk that, through adverse market fluctuations in the value of the principal sums an organisation borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequate”.*

- Access to regular market analysis through appointed Treasury Advisors
- Annual limits set and agreed for interest rate exposure and maturity levels
- Treasury Strategy sets operational limits for each financial year to limit potential exposure to market fluctuations
- Annual approval of debt financing costs as part of budget setting process

5 DEBT AND BORROWING ACTIVITY

5.1 Capital Expenditure and Associated Financing

5.1.1 In 2009/10 the total capital investment undertaken by the Council was £38.097M which resulted in a net borrowing requirement of £12.261M which was £8.671M more than originally estimated. The increase was due to the acceleration of a number of capital schemes to match grant brought forward from future years by the Scottish Government together with a reduction in the level of capital receipts and a reduced appropriation from the capital fund in line with revised debt financing cost projections. The borrowing identified has not, as yet, been undertaken and has been funded from internal cash balances.

	2009/10 Estimate £M	2009/10 Actual £M	Variance £M
Capital Expenditure			
General Fund	13.504	23.934	10.430
HRA	15.616	14.163	-1.453
Gross Capital Expenditure	29.120	38.097	8.977
Financed By:			
Capital Receipts	-4.888	-2.084	2.804
Grants & Partnership Funding	-4.324	-7.379	-3.055
Revenue (CFCR)	-5.561	-6.569	-1.008
Capital Fund – Appropriation	-1.000	-0.093	0.907
Total Financing	-15.773	-16.125	-0.352
Net Capital Expenditure	13.347	21.972	8.625
Less Principal Repaid to Loans Fund	-9.757	-9.711	0.046
Un-financed capital expenditure (Borrowing Requirement in Year)	3.590	12.261	8.671

5.2 Capital Financing Requirement

5.2.1 The Capital Financing Requirement (CFR) reflects the Council's underlying need to borrow for a capital purpose. The CFR increases whenever capital expenditure is incurred, and where this expenditure is resourced immediately, through either the application of capital grant, capital receipts, appropriation from reserves or a direct charge to revenue, the CFR will reduce at the same time that the capital expenditure is incurred resulting in no net movement in the overall CFR level.

5.2.2 Where capital expenditure is not resourced immediately, usually when it has been met from internal balances or reserves there will be a corresponding increase in the underlying need to borrow. This will be the case whether or not external borrowing

actually occurs. The CFR may be reduced in future years by further application of receipts, grant or charges to revenue and is also reduced by the amount of any annual repayment of loans fund principal.

5.2.3 The table below shows the basis of calculating the CFR, which is taken directly from the final balance sheet position each year; this shows a calculated CFR at 31 March 2010 of £238.435M. When this is compared against the actual level of external borrowing at the same time the resultant difference of £48.097m indicates an underlying borrowing requirement which has been funded at present from internal resources.

BALANCE SHEET ANALYSIS AS AT 31 MARCH 2010								
	TOTAL	Capital Financing Requirement	Balances & Reserves	Stocks, Debtors & Creditors	Cash & Investments	Borrowing & Other Long Term Liabilities	Pensions	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Fixed Assets	833.697	833.697	0.000	0.000	0.000	0.000	0.000	833.697
Long Term Debtors	0.060	0.000	0.000	0.060	0.000	0.000	0.000	0.060
Current Assets	58.685	0.000	0.000	19.448	39.237	0.000	0.000	58.685
Current Liabilities	-54.852	0.000	0.000	-47.029	-5.742	-2.081	0.000	-54.852
Net Current Assets	837.590	833.697	0.000	-27.521	33.495	-2.081	0.000	837.590
Borrowing and Long Term Liabilities	-500.275	-111.466	0.000	0.000	0.000	-204.476	-184.333	-500.275
Total Assets Less Liabilities	337.315	722.231	0.000	-27.521	33.495	-206.557	-184.333	337.315
Financed By								
Reserves and Balances	-337.315	-483.796	-54.071	0.000	0.000	16.219	184.333	-337.315
Balance at 31 March 2010	0.000	238.435	-54.071	-27.521	33.495	-190.338	0.000	0.000
		Net Indebtedness	184.364		Net Cash & Equivalents	-184.364		

Summary Position at 31 March 2010	£'000	£'000
Balances and Reserves		-54.071
Cash & Investments	33.495	
Net Debtors and Creditors	-27.521	5.974
		-48.097
Capital Financing Requirement	238.435	
External Borrowing	-190.338	
Internal Borrowing - (Borrowed in Excess of CFR)		48.097

5.3 Estimated Capital Expenditure

5.3.1 The Council's estimated net borrowing requirement for 2010/11 to 2013/14, based on the revised investment programme agreed by Cabinet on 16 June 2010 is £98.976M. This position, together with the expected movement in the overall Capital Financing Requirement arising from this level of expenditure is set out in the following table.

	2010/11		2011/12		2012/13		2013/14
	Estimated	Revised	Estimated	Revised	Estimated	Revised	Estimated
Gross Capital Expenditure	55.939	51.198	71.221	75.112	49.627	51.413	30.959
Total capital Financing	-14.582	-18.099	-15.517	-15.703	-7.443	-13.179	-8.622
Net Capital Expenditure	41.357	33.099	55.704	59.409	42.184	38.234	22.337
Less Principal Repaid to Loans Fund	-10.827	-11.138	-12.143	-12.141	-14.215	-14.044	-16.781
Estimated Borrowing Requirement	30.530	21.961	43.561	47.268	27.969	24.190	5.556
Add: Opening CFR at 1 April	232.069	238.435	262.599	260.396	306.160	307.664	331.854
Closing CFR at 31 March	262.599	260.396	306.160	307.664	334.129	331.854	337.411

5.4 Affordability of Capital Investment Programme

5.4.1 A key requirement of compliance with the Prudential Code is that the capital investment plans of the Council are affordable, prudent and sustainable and that they support local strategic planning. The forward estimate of the debt servicing costs associated with the current approved programmes is shown in the following 2 tables.

Table 5.4.1(a) – General Fund Debt Charges

SUMMARY OF DEBT FINANCING COSTS - GENERAL FUND									
	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
	Estimate	Estimate	Estimate	Estimate	Estimate	Estimate	Estimate	Estimate	Estimate
	£'M	£'M	£'M	£'M	£'M	£'M	£'M	£'M	£'M
Principal	9.750	10.568	12.228	14.768	12.069	12.144	12.658	13.132	11.757
Interest & Expenses	9.201	8.780	10.194	12.037	12.842	12.876	12.552	12.248	11.989
Recharge to Services	-0.996	-0.996	-0.873	-0.724	-0.446	-0.174	-0.117	0.000	0.000
Total	17.955	18.352	21.549	26.082	24.466	24.846	25.092	25.380	23.746
Budget	18.350	19.350	20.350	21.350	22.350	23.350	24.350	25.350	23.750
(Surplus)/Deficit	-0.395	-0.998	1.199	4.732	2.116	1.496	0.742	0.030	-0.004
Appropriation (to)/ From Capital Fund in Year	-0.395	-0.998	1.199	4.732	2.116	1.496	0.742	0.030	-0.004
Cumulative Appropriation (to) / From Capital Fund	-0.395	-1.392	-0.194	4.538	6.654	8.150	8.892	8.923	8.918

Table 5.4.1 (b) – HRA Debt Charges

SUMMARY OF DEBT FINANCING COSTS - HRA									
	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
	Estimate	Estimate	Estimate	Estimate	Estimate	Estimate	Estimate	Estimate	Estimate
	£'M	£'M	£'M	£'M	£'M	£'M	£'M	£'M	£'M
Principal	1.311	1.572	1.816	2.012	2.186	2.365	2.540	2.725	2.922
Interest & Expenses	3.713	4.088	4.113	4.053	3.974	3.953	3.931	3.898	3.867
Recharge to Services	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Total	5.025	5.660	5.929	6.065	6.161	6.318	6.471	6.624	6.789
Budget	5.372	5.660	5.930	6.065	6.161	6.320	6.470	6.625	6.790
(Surplus)/Deficit	-0.347	0.000	-0.001	0.000	0.000	-0.002	0.001	-0.001	-0.001

5.4.2 **General Fund** - The estimated debt charges associated with the delivery of the approved general fund capital programme indicate that under current arrangements an overall appropriation of £8.918M will be required from the Capital Fund to support its delivery and ensure that it remains affordable between 2010/11 and 2018/19. This is based on the assumption that the annual debt charge budget is also increased by £1.000m per annum until 2017/18. Cabinet agreed on 11 February 2009 to utilize £6.000m from the Capital Fund to smooth the impact on debt charges of accelerating the capital investment programme. As such a further £2.918m would need to be earmarked in future years over and above the £6.000m agreed to ensure the capital programme is fully resourced.

5.4.3 The repayment profile is currently under review however and any extension of this would result in a beneficial change to the overall budget position.

5.4.4 HRA - The figures presented in table 5.4.1(b) indicate that the current Housing Capital Improvement program will result in debt charges increasing in annual stages to a level of £6.790M by 2018/19.

5.5 Borrowing In Advance – Maximum Headroom for Borrowing

5.5.1 The CIPFA Prudential Code is explicit that local authorities must not borrow funds in advance of need purely to profit from on lending the monies. Borrowing in advance is defined as any borrowing undertaken by the local authority which would result in the total external debt exceeding the Capital Financing Requirement in any 12 month rolling period. As such all borrowing decisions should be supported by an evaluation to demonstrate there is no breach of the Code.

5.5.2 The estimated future borrowing to fully resource the planned capital investment in the current and future 3 financial years is identified at paragraph 5.3.1 as £103.011M. The evaluation of the current external debt and forecast CFR position indicate that the range of borrowing that could be undertaken during 2010/11 without breaching the statutory limit for advance borrowing is £64.892M (April 2010) to £134.189M (March 2011).

5.5.3 Given the range identified in paragraph 5.5.2 the Executive Director of Finance and Corporate Support advises that current and future market and economic conditions will be closely monitored and should a requirement to borrow up to the level of anticipated CFR be considered financially advantageous, in response to changing economic and political circumstances, amounts up to the maximum calculated limit may be undertaken and will be reported to future meetings of this Committee.

5.6 Debt Rescheduling

5.6.1 The Council's appointed Treasury Advisors, Arlingclose Ltd, continues to review the debt portfolio against prevailing and forecast interest rate and economic conditions. Interest rates remain at historically low levels with shorter dated variable rate loans available at rates below 0.7%. As a result the Advisors have identified a number of possible rescheduling opportunities which would result in the repayment of £28.380m fixed rate Public Work Loan Board debt, refinanced by a variable rate loan at a rate of between 0.65% and 0.70%. Whilst there would be a premium charged on repayment of the original loans this would be spread over a maximum period of 10 years in line with accepted accounting practice.

5.6.2 The expected savings arising from this proposal are estimated to be approximately £0.874M over a period of 11 years using a fairly pessimistic assumption on interest rate increases from 2014/15. These are presented for information below. Whilst there is a possibility that variable rate interest rates could rise over the period the probability, especially in the early years is considered low. Should this become a concern however the facility exists to repay variable rate debt and lock into longer dated fixed rate debt. This position in respect of interest rate movement and sensitivity will continue to be monitored by The Executive Director of Finance and Corporate Support to ensure that any rescheduling is carried out when it is considered economically advantageous.

Table 5.6.2 – Expected revenue savings from debt rescheduling

ASSUMPTIONS	2010/11	2011/12	2012/13	2013/14 - 2020/21	
Current Level of External Debt	£201,803,063	£201,803,063	£201,803,063	£201,803,063	
Forecast Level of External Investments	£33,000,000	£33,000,000	£33,000,000	£33,000,000	
Weighted Average of External Debt (%) Before Rescheduling	5.735%	5.735%	5.735%	5.633%	
Weighted Average of External Debt (%) After Rescheduling	5.207%	5.277%	5.382%	5.571%	
	2010/11	2011/12	2012/13	2013/14 - 2020/21	TOTAL
Estimated Interest Costs - Before Rescheduling					
Debt	11,573,406	11,573,406	11,573,406	88,886,621	123,606,838
Investments	-330,000	-495,000	-825,000	-12,210,000	-13,860,000
	11,243,406	11,078,406	10,748,406	76,676,621	109,746,838
Estimated Interest Costs - After Rescheduling					
Debt	10,507,885	10,649,148	10,861,041	87,903,759	119,921,833
Investments	-330,000	-495,000	-825,000	-12,210,000	-13,860,000
Total	10,177,885	10,154,148	10,036,041	75,693,759	106,061,833
Add: Cost of Premium	266,908	275,401	291,173	2,009,091	2,842,573
Total	10,444,794	10,429,548	10,327,214	77,702,851	108,904,406
Savings Projected from Rescheduling	798,612	648,857	421,192	-1,026,230	842,431

6 INVESTMENT ACTIVITY AND FUTURE STRATEGY

6.1 Background

6.1.1 The Exchequer Division of the Finance Service undertakes the daily management of the Council's cash and surplus balances. These balances are derived from short term excesses of income over expenditure, and also represent the general and specific balances held in reserves at any point in time.

6.1.2 Surplus balances are invested primarily to ensure the security and liquidity of the capital and only thereafter is an optimum yield commensurate with the security and liquidity considered.

6.1.3 Counterparties are subject to significant scrutiny in consultation with our Treasury Advisors prior to any sums being placed with them. This includes information in respect of credit ratings and whether they are participants in the UK Credit Guarantee Scheme. The Advisors also utilize additional market information to analysis counterparty performance.

6.1.4 Following the challenging economic conditions facing Spain including the fiscal challenges ahead for the country and concerns over the effect of rising debt funding costs, and the downgrading of Spain's sovereign rating to AA by Standard and Poors, the decision was taken to suspend any further deposits with Spanish banks in quarter 1. This specifically excluded BBVA and Banco Santander from our counterparty list. Deposits with Santander UK Plc (a wholly owned subsidiary of Banco Santander) have been restricted to a maximum of 1 month.

6.2 Investment Activity – Quarter 1 to 30 June 2010

6.2.1 The table below shows the investment activity of the Council over the first quarter of the financial year. Overall the level of short term deposits increased by £5.017m with just over £195.000m of overall investment activity taking place. The average interest rate earned was 0.86% which although considerably less than in previous financial

years compares favourably to the London InterBank Bid Rate (LIBID) of 0.56% which is the rate the major banks are prepared to borrow at.

	Lowest Credit Rating	Type of Investment	<u>Balance at 1 April 2010</u>	<u>Investments Made to 30/6/2010</u>	<u>Investments Repaid to 30/6/2010</u>	<u>Balance at 30 June 2010</u>	<u>Average Interest Rate @ 30/6/10</u>
Royal Bank of Scotland	A+	(Call Account)	7,895,651	7,604,758	7,450,029	8,050,379	0.80%
Bank of Scotland	A+	(Call Account)	22,549	2,732	0	25,281	0.50%
Clydesdale	A+	(Call Account)	7,398,069	37,054,186	43,847,255	605,000	0.50%
Clydesdale	A+	(15 Day Notice)	0	11,572,576	5,370,000	6,202,576	0.75%
Clydesdale	A+	(30 Day Notice)	0	3,200,885	2,000,000	1,200,885	0.80%
Santander	AA-	(Call Account)	7,263,951	8,513,865	13,040,000	2,737,816	0.80%
Santander	AA-	(15 Day Notice)		3,000,000		3,000,000	0.80%
Barclays	AA-	(Call Account)	4,004,574	19,625,157	17,850,000	5,779,731	0.60%
Bank of Scotland	A+	(Fixed term deposits)	7,500,000	5,500,000	5,500,000	7,500,000	1.32%
Nationwide	A+	(Fixed term deposits)	3,000,000	4,000,000	0	7,000,000	0.83%
Icelandic Banks	C	Default	2,078,866	0	0	2,078,866	0%
			<u>39,163,660</u>	<u>100,074,159</u>	<u>95,057,284</u>	<u>44,180,535</u>	<u>0.86%</u>

6.3 Scottish Investment Regulations

6.3.1 These came into force on 1 April 2010 and provide for a wider range of investments vehicles to be utilized and also provide for investment of funds beyond the previous limit of 364 days.

6.3.2 The Treasury Investment Strategy approved by Cabinet on 31 March 2010 set out the various types of investment and also the maximum maturity periods which would be utilized for each. Notwithstanding this approval investments have continued to be restricted to those institutions covered by the UK Government Credit Guarantee Scheme.

6.3.3 The anticipated investment activity in the remainder of quarter 2 and all of quarter 3 will continue to adopt a prudent position with investments placed in line with existing restrictions. Work will however be undertaken in consultation with Arlingclose to assess the suitability and availability of a wider base of alternative institutions and also the advantages from longer durations of investments.

7 PRUDENTIAL AND LOCAL PERFORMANCE INDICATORS

7.1 Out turn Prudential Indicators 2009/10 and Estimates 2010/11 to 2012/13

7.1.1 It is a requirement of The Prudential Code that the actual prudential indicators for each financial year are reported to members. A number of these indicators provide either an overview or a limit on treasury activity attributing limits to ensure that external borrowing remains sustainable and affordable in the medium to longer term. The financial impact of borrowing is also highlighted through the estimated impact on both the Council Tax level and housing rents together with the overall ratio of financing costs to net revenue streams.

7.1.2 The prudential indicators for 2009/10, together with revised estimates for the period 2010/11 to 2012/13 are set out in Appendix 1 of the report. This confirms that the

Council complied with all of the treasury management prudential indicators during 2009/10.

7.2 Performance Indicators

7.2.1 The headline performance indicator for treasury management is the average cost of servicing loans as reflected in the consolidated loans fund interest and expenses rate – the pool rate. The performance over the last 3 financial years calculated in accordance with LASAAC guidance is shown below.

Year	Opening Advances £'M	Closing Advances £'M	Average Advances £'M	Interest & Expenses £'M	Pool Rate %
2007/08	187.541	208.037	197.789	12.168	6.15%
2008/09	208.037	220.550	214.294	11.813	5.52%
2009/10	220.550	232.811	226.680	12.249	5.40%

7.2.2 The reduction in the pool rate reflects the decision to delay external borrowing and continue to fund expenditure from internal balances and reserves with the reduction in short term investment income, at rates of less than 1%, considered against any additional costs that would be incurred from longer term borrowing at rates of around 4% at present.

8 FINANCIAL IMPLICATIONS

8.1 There are no immediate financial implications arising from the report. The costs associated with financing capital expenditure are contained within the revenue budgets for both the General Fund and Housing Revenue Account.

9 LEGAL AND POLICY IMPLICATIONS

9.1 The treasury management policies and practices have been complied with during the year.

10 RECOMMENDATIONS

10.1 It is recommended that Members:-

- i) Note the contents of this report.

Alex McPhee
Executive Head of Finance and Corporate Support

RB/
30 July 2010

LIST OF BACKGROUND PAPERS

1. Report to Cabinet 31 March 2010 – Treasury Management & Investment Strategy 2010/11 to 2012/13

Members wishing further information should contact Robin Baker, Financial Controller,
Telephone (01563) 576331.

**PRUDENTIAL INDICATORS 2009/10 OUT TURN and REVISED ESTIMATES FOR
2010/11 TO 2012/13**

1 Background:

- 1.1 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

2. Net Borrowing and the Capital Financing Requirement:

- 2.1 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 total 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.

	2009/10		2010/11	2011/12	212/13
	Estimate	Actual	Estimate	Estimate	Estimate
Total Debt	221.903	202.572	224.638	271.938	296.163
Less Investments	-20.000	-39.164	-33.000	-33.000	-33.000
Net External Debt	201.903	163.408	191.638	238.938	263.163
CFR Comparator	315.301	307.740	331.930	337.487	330.544
Ratio	64.03%	53.10%	57.73%	70.80%	79.62%

The Executive Director of Finance and Corporate Support reports that the Council 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.

	2009/10		2010/11		2011/12		2012/13	
	Revised	Actual	Original Estimate	Revised Estimate	Original Estimate	Revised Estimate	Original Estimate	Revised Estimate
Capital Expenditure								
Non HRA	24.963	23.934	41.544	36.806	58.342	62.248	38.979	40.780
HRA	14.097	14.163	14.395	14.392	12.879	12.864	10.648	10.633
Total Expenditure	39.060	38.097	55.939	51.198	71.221	75.112	49.627	51.413
Less: Capital Financing								
Receipts	2.365	2.084	2.202	2.202	1.730	1.730	1.782	1.782
Grants	7.909	7.379	4.219	7.736	5.626	5.172	0.000	5.097
CFCR	6.355	6.569	5.661	5.661	5.661	5.661	5.661	5.661
Capital Fund	1.200	0.093	2.500	2.500	2.500	3.140	0.000	0.639
Total Financing Applied	17.829	16.125	14.582	18.099	15.517	15.703	7.443	13.179
Less: Principal Repaid to Loan Fund	9.711	9.711	11.062	11.062	12.141	12.141	14.044	14.044
Net Borrowing Requirement	11.520	12.262	30.295	22.037	43.563	47.268	28.140	24.190
Represented By:								
Supported Borrowing	7.130	7.130	7.130	7.130	7.130	7.130	7.130	7.130
Prudential Borrowing	4.390	5.132	23.165	14.907	36.433	40.138	21.010	17.060
Total	11.520	12.262	30.295	22.037	43.563	47.268	28.140	24.190
Total Financing Applied and Borrowing	39.060	38.097	55.939	51.198	71.221	75.112	49.627	51.413

The net borrowing requirement is used to determine the additional interest costs in the current and future years when calculating the forward estimate of debt financing costs.

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 Actual £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
Non-HRA	6.35%	6.22%	6.51%	6.92%	7.32%
HRA	14.33%	13.63%	15.25%	15.88%	16.29%

5. Incremental Impact of Capital Investment Decisions:

5.1 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	2011/12 Estimate	2012/13 Estimate
Increase in Band D Council Tax	-	£3.75	£1.47
Increase in Average Weekly Housing Rents	£0.10	£0.33	£0.37

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.

6. Authorised Limit and Operational Boundary for External Debt:

6.1 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.

- 6.2 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.

- 6.3 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. This limit includes sufficient headroom to undertake any additional borrowing that may be determined as set out in paragraph 5.5 of the covering report.
- 6.4 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.
- 6.5 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.

	2009/10 Actual £m	2010/11 Revised Estimate £m	2011/12 Revised Estimate £m	2012/13 Revised Estimate £m
Authorised Limit for External Debt	304.252	334.040	366.400	334.916
Operational Boundary for External Debt	289.763	318.134	348.953	318.967
Total External Debt	202.572	224.638	271.938	296.162

7. Adoption of the CIPFA Treasury Management Code:

- 7.1 This indicator demonstrates that the Council has adopted the principles of best practice. Adoption of the revised Code of practice was recommended and approved by Cabinet on 31 March 2010.

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

- 8.1 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))

- 8.2 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 Actual	2010/11 Projected	2011/12 Projected	2012/13 Projected	2010/11 Increase Variable Rate Borrowing	2010/11 - Increase Overall Borrowing
	%	%	%	%	%	%
Upper Limit on Fixed Rate Exposures	150%	150%	150%	150%	150%	150%
Upper Limit of variable rate Exposures	40%	40%	40%	40%	40%	40%
Actual/Projected Position	£'M	£'M	£'M	£'M	£'M	£'M
Total Debt	202.572	224.638	271.938	296.163	224.638	310.516
Total Investments	-39.164	-33.000	-33.000	-33.000	-33.000	-33.000
Total Net Debt	163.408	191.638	238.938	263.163	191.638	277.516
Represented By:						
Fixed Debt	166.203	188.269	214.069	228.794	160.039	188.269
Fixed Investments	0.000	0.000	0.000	0.000	0.000	0.000
Fixed Net Debt	166.203	188.269	214.069	228.794	160.039	188.269
Variable Debt	36.369	36.369	57.869	67.369	64.599	122.247
Variable Investments	-39.164	-33.000	-33.000	-33.000	-33.000	-33.000
Variable Net Debt	-2.795	3.369	24.869	34.369	31.599	89.247
Exposure: Fixed Debt/Total Net Debt	101.71%	98.24%	89.59%	86.94%	83.51%	67.84%
Exposure: Variable Net Debt/Total Net Debt	-1.71%	1.76%	10.41%	13.06%	16.49%	32.16%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

- 8.3 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.

- 8.4 For information the table above also shows the estimated change that would take place if i) variable rate loans were increased through the proposed rescheduling of existing debt and ii) if additional variable rate borrowing was undertaken to mitigate against any changes in market or economic conditions. In both scenarios it can be seen that the overall limits would not be breached.

9. Maturity Structure of Fixed Rate borrowing:

- 9.1 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.

- 9.2 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%

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

- 10.1 These limits are set to reduce the need to redeem debt prematurely, which could result in loss of interest and/or penalty charges. The Investment guidance issued by the Scottish Government and effective from 1 April 2010 now allows Councils the flexibility to determine the type and duration of investments. As a result the following limits, which were previously only indicative, will now be adopted.

Upper Limit for Total Principal Sums Invested over 364 days	2010/11	2011/12	2012/13
Under 12 Months	100%	100%	100%
12 Months to 2 Years	40%	40%	40%
2 Years to 5 Years	10%	10%	10%
5 Years to 10 Years	5%	5%	5%
10 Years and above	5%	5%	5%