Committee and Date	Item
CMT 31 January 2011 Audit Committee 08 February 2011 Cabinet 15 February 2011 Council 24 February 2011	 Public

TREASURY STRATEGY 2011/12

Responsible Officers Graham Chidlow & Justin Bridges

e-mail: graham.chidlow@shropshire.gov.uk Justin.bridges@shropshire.gov.uk Tel: (01743) 252072/252077 Fax (01743) 252184

Summary

The report proposes the Treasury Strategy for 2011/2012 and recommends Prudential Indicators for 2011/12 to 2013/14. The report is technical in nature but the key points to note are:-

- Borrowing is largely driven by the Capital Programme Strategy. From 2011/12 the Council's borrowing requirement has been significantly reduced due to the Government changing the way in which it funds the Council's capital expenditure and providing capital grants rather than support via revenue support grant. The Treasury Strategy includes prudential borrowing of £16.8 million for 2011/12 of which £2.5 million relates to previously approved schemes that will generate savings which will cover the revenue costs of the borrowing.

- Every attempt is being made to reduce this prudential borrowing by raising capital receipts. Further options are being explored to reduce the remaining £14.3 million of prudential borrowing. The capital programme strategy report highlights for 2012/13 to 2015/16 additional prudential borrowing of £12.4 million which will be financed from within existing resources.

- The Council's lending is still restricted to UK Banks and Building Societies, Nationalised and Part Nationalised Institutions which meet Sector's creditworthiness policy, other Local Authorities and the UK Government.

- The internal Treasury Team will continue to look for opportunities to make savings by actively managing the cash and debt portfolio in accordance with the Treasury Strategy.

- The claim for the £1 million deposit placed by Bridgnorth District Council with the Icelandic Bank, Landsbanki has been accepted as a priority claim by the Landsbanki Winding up Board. It is currently thought that priority creditors will be repaid 95% of their deposits. The first payment is expected in October 2011 with the final payment in October 2018. However, non priority creditors have objected to the criteria for priority creditors. Non priority creditors are currently expected to be repaid 38% of their deposits.

- The bank rate is currently 0.50% and it is uncertain as to when this will rise. Every 0.25% increase in the base rate equates to around £250,000 of additional interest receivable per annum on the Council's investments.

- Long term borrowing rates are expected to be higher than investment rates during 2011/12 therefore long term borrowing may be postponed in order to maximise savings in the short term. If borrowing is not undertaken in 2011/12 this would result in savings of around £137,000.

- The Council has agreed to offer to lend funds to Shropshire Housing Ltd (which incorporates both South Shropshire Housing Association and the Meres & Mosses Housing Association) and Severnside Housing at an agreed rate. In the current climate Housing Associations can find it difficult to obtain funding for new affordable housing. It has been agreed to offer to lend up to £10 million to each of these Housing Associations in order to support the building of affordable housing and shared office accommodation in Shropshire. For security purposes, each loan will be secured against existing assets held by or owned by the Housing Association. If Shropshire Rural were to request a similar facility, for a smaller amount given the size of this local Housing Association, this could also be facilitated.

Recommendations to Cabinet

Cabinet recommend that council:-

a) Approve the Treasury Strategy for 2011/2012.

b) Approve the Prudential Indicators, set out in Appendix 1, in accordance with the Local Government Act 2003.

c) Approve the Investment Strategy, set out in Appendix 2 in accordance with the DCLG Guidance on Local Government Investments.

d) Approve the Minimum Revenue Provision (MRP) Policy Statement, set out in Appendix 3.

e) Authorise the Section 151 Officer to exercise the borrowing powers contained in Section 3 of the Local Government Act 2003 and to manage the Council's debt portfolio in accordance with the Treasury Strategy.

f) Authorise the Section 151 Officer to use Foreign Banks which meet Sector's creditworthiness policy and Money Market Funds again if required when money markets stabilise.

g) Note the proposed Prudential Indicators would enable the Authority to use the equivalent of up to 3% of Council Tax in 2011/12 or future years, to fund borrowing under the Prudential Code should the Council decide to do so.

Recommendations to Audit Committee

h) Audit Committee are asked to note the report.

Recommendations to the Council

i) Approve the Treasury Strategy for 2011/2012.

j) Approve the Prudential Indicators, set out in Appendix 1, in accordance with the Local Government Act 2003.

k) Approve the Investment Strategy, set out in Appendix 2 in accordance with the DCLG Guidance on Local Government Investments.

l) Approve the Minimum Revenue Provision (MRP) Policy Statement, set out in Appendix 3.

m) Authorise the Section 151 Officer to exercise the borrowing powers contained in Section 3 of the Local Government Act 2003 and to manage the Council's debt portfolio in accordance with the Treasury Strategy.

n) Authorise the Section 151 Officer to use Foreign Banks which meet Sector's creditworthiness policy and Money Market Funds again if required as money markets continue to stabilise.

o) Note the proposed Prudential Indicators would enable the Authority to use the equivalent of up to 3% of Council Tax in 2011/12 or future years, to fund borrowing under the Prudential Code should the Council decide to do so.

REPORT

Introduction

1. The Council defines its treasury management activities as "the management of the authority's investments and 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".

2. This strategy statement has been prepared in accordance with CIPFA's revised Code of Practice (2009). Accordingly, the Council's Treasury Strategy will be approved annually by full Council and there will also be a mid year report. In addition, monitoring reports will be submitted quarterly to CMT and Cabinet. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of policies and practices, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

3. The Council will adopt the following reporting arrangements in accordance with the requirements of the revised Code:-

Area of Responsibility	Council/Committee/Officer	Frequency
Treasury Management	Full Council/Cabinet	Initial adoption 2010

Policy Statement (revised)		
Treasury Strategy/Annual Investment Strategy/MRP Policy	Full Council/Cabinet	Annually before the start of the financial year
Treasury Strategy/Annual Investment Strategy/MRP Policy – mid year report	Full Council/Cabinet	Mid year
Treasury Strategy/Annual Investment Strategy/MRP Policy – updates or revisions at other times	Full Council/Cabinet	As required
Annual Treasury Report	Full Council/Cabinet	Annually by 30 September after the end of the financial year
Treasury Management Monitoring Reports	Reports prepared by Treasury Manager to the Head of Finance (Treasury & Pensions) who reports to the S151 Officer	Monthly
Treasury Management Practices	Section 151 Officer	Annually
Scrutiny of Treasury Strategy	Audit Committee	Annually before the start of the financial year
Scrutiny of the treasury management performance	Audit Committee	Half yearly

Treasury Strategy 2011/2012

4. The Local Government Act 2003 and supporting Regulations requires the Council to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that capital investment plans are affordable, prudent and sustainable. This report incorporates the indicators to which regard should be given when determining the Council's Treasury Management Strategy for the next financial year.

5. As the Council is responsible for housing, Prudential Indicators relating to Capital Expenditure, financing costs and the Capital Financing Requirement will be split between the Housing Revenue Account (HRA) and the General Fund. The impact of any new capital investment decisions on housing rents will also need to be considered.

6. The Act also requires the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy. This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

7. The proposed Strategy for 2011/12 in respect of the following aspects of the treasury management function is based upon the S151 Officers' view on interest rates, supplemented with leading market forecasts provided by the Council's Treasury Advisor, Sector Treasury Services.

8. The proposed strategy will focus on the following areas of treasury activity:-

- Treasury limits in force which will limit the treasury risk and activities of the Council.
- The determination of Prudential and Treasury Indicators.
- The current treasury position.
- Prospects for interest rates.

- Capital borrowing strategy.
- Policy on borrowing in advance of need.
- Debt rescheduling opportunities.
- Investment strategy.
- Creditworthiness policy.
- Policy on use of external service providers.
- The MRP strategy.
- Leasing.

9. It is a statutory requirement under section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from:-

   - increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
   - any increase in running costs from new capital projects

   are limited to a level which is affordable within the projected income of the Council for the foreseeable future. The Local Government Act 2003 section 25 also requires the robustness of costs, a separate report has been written on this issue and sent to Cabinet in January 2011.

Treasury Limits for 2011/12 to 2013/14

10. It is a statutory requirement under Section 3 of the Local Government Act 2003 and supporting Regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". This authorised limit represents the legislative limit specified in section 3 of the Local Government Act 2003.

11. The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax levels is 'acceptable'.

12. Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate those planned to be financed by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Borrowing Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years and is the limit which the Council must not breach. All of the other Prudential Indicators are estimates only and can be breached temporarily but this is very rarely the case. If this did happen it would be reported to Members outlining the reasons for this temporary breach.

13. The Council are asked to approve these Prudential Indicators.

Prudential Indicators for 2011/2012 to 2013/2014

14. The Prudential Code and CIPFA Code of Practice require the Council to set 17 Prudential Indicators. In addition to the specified indicators, we have set 4 further

internal indicators for Treasury Management, regarding lower limits on interest rate exposure for both borrowing and investments.

15. It should be noted that these indicators should not be used for comparison with indicators from other local authorities. Use of them in this way would be likely to be misleading and counter-productive as other authorities Treasury Management policies and practices vary. The most important indicator is prudential indicator number 10 which specifies the authorised limit which cannot be breached under any circumstances. In the event that this indicator was breached a separate report would be brought to Council and the Audit Commission informed.

16. **Prudential Indicator 1 & 2** - The ratio of financing costs indicator shows the trend in the cost of financing capital expenditure as a proportion of the Authority's net revenue. These include the financing costs of supported capital expenditure, prudential borrowing and finance leases. This indicator also shows the ratio of the HRA financing costs to the HRA net revenue stream. Although the future capital programme has been cut the ratio of financing costs for future years have increased because the Council's net revenue stream has fallen by a greater margin than the financing costs.

Prudential Indicator No. 1 & 2	2010/11 Estimate	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate
	%	%	%	%
Non HRA ratio of financing costs (gross of investment income) to net revenue stream	10.5	11.5	12.3	12.2
Non HRA ratio of financing costs (net of investment income) to net revenue stream	10.1	11.1	11.8	11.7
HRA Ratio of financing costs to HRA net revenue stream	15.4	14.9	14.7	14.4

17. The 2011/2012 to 2015/16 Capital Budget includes prudential borrowing of £16.8 million for 2011/12, £4.2 million for 2012/13 and £4 million for 2013/14.

18. The prudential borrowing in 2011/12 includes £2.5 million in carbon efficiency and other spend to save schemes which will generate savings to cover the revenue costs of prudential borrowing. Options are being explored to reduce the remaining £14.3 million as detailed in the capital strategy report. The debt charges associated with these projects will be met from within existing resources and savings generated from spend to save schemes.

19. The capital programme 2011/12 to 2015/16 report includes additional prudential borrowing of £12.4 million for various schemes of which £9 million is included for potential school reorganisation. If required, the cost of this will be met from savings within school budgets. The debt charges associated with the other projects will be met from within existing resources and savings generated from the energy efficiency schemes.

20. **Prudential Indicator 3** - In accordance with Prudential Guidelines the costs of all prudential borrowing, together with an estimate for finance leases, are included in prudential indicators even though they will be funded from existing revenue budgets. The HRA budgetary requirements for the authority have also been calculated by taking the difference between the existing capital programme and any changes proposed in the new capital programme. It is anticipated that there will be no unsupported borrowing relating to the HRA therefore the addition or reduction to average weekly housing rents for 2011/12 to 2013/14 is zero. The figures quoted

include Prudential Borrowing already utilised totalling £18.8 million from 2006/07 to 2010/11.

Prudential Indicator No. 3	**2011/12**	**2012/13**	**2013/14**
Estimates of impact of Capital Investment decisions in the present capital programme	**£ p**	**£ p**	**£ p**
Cost of capital investment decisions funded from re-direction of existing resources (Band D, per annum)	23.20	34.02	36.46
Cost of capital investment decisions funded from increase in council tax (Band D, per annum)	0	0	0
Cost of capital investment decisions funded from increase in average housing rent per week	0	0	0
Total	**23.20**	**34.02**	**36.46**

21. **Prudential Indicator 5, 8, 9** - A key indicator of prudence is that net external borrowing should not, except in the short term, exceed the capital financing requirement (CFR). The capital financing requirement is the maximum we would expect to borrow based on the current capital programme. Compliance with the indicator will mean that this limit has not been breached. Gross borrowing includes debt administered on behalf of the Borough of Telford and Wrekin, Magistrates Courts and Probation Service. It also includes the debt transferred from Oswestry Borough Council and North Shropshire District Council on the 1st April 2009. In accordance with the Code the HRA Capital Financing requirement has been calculated separately from 2009/10 onwards.

Prudential Indicator No. 5 * No. 8 & 9^	**2009/10 Actual**	**2010/11 Estimate**	**2011/12 Estimate**	**2012/13 Estimate**	**2013/14 Estimate**
Net Borrowing & Capital Financing Requirement:	**£ m**	**£ m**	**£ m**	**£ m**	**£ m**
Non HRA Capital Financing Requirement^	279	293	299	292	285
Gross Borrowing*	280	293	298	290	280
Investments*	100	90	90	90	90
Net Borrowing*	180	203	208	200	190
HRA Capital Financing Requirement^	1.2	1.2	1.2	1.3	1.3

22. **Prudential Indicator 6 & 7** - The estimated capital expenditure has been split between Non HRA and HRA and represents commitments from previous years to complete ongoing schemes, the expenditure arising from the proposed new schemes within the capital programme for 2011/12, and the estimated expenditure for 2012/13 and 2013/14.

Prudential Indicator No. 6 & 7	2009/10 Actual	2010/11 Estimate	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate
	£ m	£ m	£ m	£ m	£ m
Non HRA Capital expenditure	77	89	73	33	28
HRA Capital expenditure	1	6	4	3	3

23. **Prudential Indicator 10 which must not be breached** - The authorised limit is the borrowing limit set for Shropshire Council. This indicator shows the maximum permitted amount of outstanding debt for all purposes. It includes three components:

    1. The maximum amount for capital purposes;
    2. The maximum amount for short term borrowing to meet possible temporary revenue shortfalls;
    3. The maximum permitted for items other than long term borrowing i.e. leasing.

Prudential Indicator No. 10	2011/12	2012/13	2013/14
External Debt	**£ m**	**£ m**	**£ m**
Authorised Limit for External Debt:			
Borrowing	412	408	392
Other long term liabilities	41	41	39
Total	**453**	**449**	**431**

24. **Prudential Indicator 11** – The more likely outcome for the level of external debt is shown in the operational boundary which the Council is required to set. This is calculated on the same basis as prudential indicator number 10 however, it is seen as a more likely outcome.

Prudential Indicator No. 11	2011/12	2012/13	2013/14
External Debt	**£ m**	**£ m**	**£ m**
Operational Boundary:			
Borrowing	348	350	338
Other long term liabilities	35	35	34
Total	**383**	**385**	**372**

25. **Prudential Indicator 12** - The estimated external debt is based on the capital programme for 2010/11.

Prudential Indicator No. 12	31/03/10 Actual	31/03/11 Estimate
Actual External Debt	**£ m**	**£ m**
Borrowing	280	293
Other long term liabilities	20	25
Total	**300**	**318**

Prudential Indicator number 13 relates to the Local Authority adopting the CIPFA Code of Practice for Treasury Management in Public Services. The original 2001 Code was adopted by full Council in February 2002. Shropshire Council adopted the revised Code in February 2010.

26. **Prudential Indicator 14 & 15** - The Prudential Code requires the Council to set interest rate exposure limits for borrowing and investments.

Prudential Indicator No. 14* Internal Indicator No. 1 ** No. 15 ^ Internal Indicator No. 2 ^^	**2011/12**	**2012/13**	**2013/14**
Borrowing Limits			
	£ m	**£ m**	**£ m**
Upper Limit for Fixed Interest Rate Exposure *	348	350	338
Upper Limit for Variable Interest Rate Exposure ^	174	175	169
Lower Limit for Fixed Interest Rate Exposure **	174	175	169
Lower Limit on Variable Interest Rate Exposure ^^	0	0	0

These indicators seek to control the amount of debt exposed to fixed and variable interest rates. Variable rate debt carries the risk of unexpected increases in interest rates and consequently increases in cost. The upper limit for variable rate exposure has been set following advice from Sector, however, this limit is never likely to be reached due to authority's objective to have no more than 25% of outstanding debt at variable interest rates.

Upper limit for fixed rate exposure
Calculation: A maximum of 100% of the Operational Boundary (£348m in 2011/12) exposed to fixed rates is consistent with the Authority's objective to have a long term stable debt portfolio.

Upper limit for variable rate exposure
Calculation: For efficient management of the debt portfolio it is considered prudent by Sector to permit up to 50% (£174m in 2011/12) of the operational boundary to be borrowed at variable interest rates.

Lower limit for fixed rate exposure
Calculation: Upper limit for fixed rate exposure less the maximum permitted borrowing at variable interest rates

Lower limit for variable rate exposure
Calculation: To be consistent with the Authority's objective to have a long term stable portfolio all of the debt portfolio could be at a fixed rate therefore the lower limit for variable rate exposure should be nil.

Prudential Indicator No. 14*	**2011/12**	**2012/13**	**2013/14**

Internal Indicator No. 3 ** **No. 15 ^** **Internal Indicator No. 4 ^^**			
Investment Limits			
	£ m	**£ m**	**£ m**
Upper Limit for Fixed Interest Rate Exposure *	200	200	200
Upper Limit for Variable Interest Rate Exposure ^	200	200	200
Lower Limit for Fixed Interest Rate Exposure **	0	0	0
Lower Limit on Variable Interest Rate Exposure ^^	0	0	0

These indicators seek to control the amount of investments exposed to fixed and variable interest rates. Variable rate investments are subject to changes in interest rates, but have a higher degree of liquidity and action can be taken at short notice in response to interest rate changes.

Upper limit for fixed rate exposure
Calculation: Maximum amount of fixed rate investments in order to maintain a stable investment portfolio.

Upper limit for variable rate exposure
Calculation: For the purposes of efficient portfolio management in response to interest rate conditions a maximum potential exposure to variable rates of £200m in 2011/12 is recommended.

Lower limit for fixed rate exposure
Calculation: A lower limit of zero is locally set so as to enable full advantage to be taken of market conditions.

Lower limit for variable rate exposure
Calculation: A lower limit of zero is locally set so as to enable full advantage to be taken of market conditions.

27. **Prudential Indicator 16** - The upper and lower limit for the maturity structure of borrowings is detailed below.

Prudential Indicator No. 16	**Upper Limit**	**Lower Limit**
Maturity Structure of Fixed Rate Borrowing 2011/12*	**%**	**%**
Under 12 months	15	0
12 months & within 24 months	15	0
24 months & within 5 years	45	0
5 years & within 10 years	75	0
10 years & above	100	50

- **The internal limit is to have no more than 15% of total outstanding debt maturing in any one financial year. This is to ensure that the risk of having to replace maturing debt at times of high interest rates is controlled.**

28. **Prudential Indicator 17** - The Council is required to set maximum levels for investments over 364 days for both the internal treasury team and an external fund manager if appointed.

Prudential Indicator No. 17	2011/12	2012/13	2013/14
Investment Limits			
	£m	£m	£m
Upper Limit for Total Principal Sums Invested for over 364 days:			
Externally Managed (if appointed)	30	30	30
Internally Managed	40	40	40

Rationale: The limit for the external cash fund manager has been set at £30 million in the event that an external manager is appointed. The limit for the internal treasury team has been set in order for the authority to potentially take advantage of more stable returns going forward and the potential to lend to local Housing Associations.

Current Treasury Position

29. The Council's treasury position at 31 December 2010 is set out below:-

Outstanding debt for capital purposes		**Actual £m**
Long-term fixed rate PWLB		230
Long term fixed rate – Market	49	
Total		**279**

Investments	**£m**
Internally managed - long term (1 Year)	18
- short term cash flow	70
Total	**88**

Prospects for Interest Rates

30. The Council retains the services of Sector Treasury Services as adviser on treasury matters and part of the service provided is to help the Council to formulate a view on interest rates. The following table gives the latest Sector central view:-

Sector's interest rate forecast as at January 2011

	Mar 2011 %	June 2011 %	Sept 2011 %	Dec 2011 %	Mar 2012 %	June 2012 %	Sept 2012 %	Dec 2012 %	Mar 2013 %
Bank Rate	**0.50**	**0.50**	**0.50**	**0.75**	**1.00**	**1.25**	**1.50**	**1.75**	**2.25**
5yr PWLB rate	**3.30**	**3.30**	**3.40**	**3.50**	**3.60**	**3.80**	**3.90**	**4.10**	**4.30**
10yr PWLB rate	**4.40**	**4.40**	**4.40**	**4.50**	**4.70**	**4.80**	**4.90**	**5.00**	**5.10**
25yr PWLB rate	**5.20**	**5.20**	**5.20**	**5.30**	**5.30**	**5.40**	**5.40**	**5.40**	**5.50**
50yr PWLB rate	**5.20**	**5.20**	**5.20**	**5.30**	**5.30**	**5.40**	**5.40**	**5.40**	**5.50**

The Council has budgeted for a cost of borrowing of 5.5% in 2011/12. Interest received on revenue balances is expected to be between 0.70% to 1.0% in 2011/12.

Sector's current interest rate view is that Bank Rate will: -

- rise from its current level of 0.50% to 0.75% in 2011.
- reach 1% by the end of the financial year.
- rise to 2.25% by March 2013.

The effect on interest rates for the UK, is expected to be as follows:-

Short-term interest rates (investments)

31. Taking all the evidence together, it is felt that base rate will rise from its current level of 0.50% to 0.75% in December 2011. Bank rates are expected to end the financial year at 1% following a 0.25% rise in March 2012. Although rates are expected to rise the next financial year is still expected to be a time of historically low investment rates. There is a downside risk to this forecast if recovery from the recession proves to be weaker and slower than currently expected.

Long-term interest rates (borrowing)

32. The 50 year PWLB rate is expected to rise gradually from current levels of 5.20% to reach 5.30% by the end of the financial year. It is then anticipated to rise gradually to reach 5.50% by the end of March 2013. There is scope for it to move around the central forecast by + or – 0.25%. The 25 year PWLB rate is also expected to rise gradually from 5.20% to reach 5.30% by the end of the financial year. It is then anticipated to rise to 5.50% by the end of March 2013. The 10 year PWLB rate is expected to rise from current levels of 4.40% to reach 4.70% by the end of the financial year. Again further rises are expected in 2012/13. The 5 year PWLB rates are also expected to rise from 3.30% to 3.60% by the end of March 2012 and to 4.30% by the end of March 2013.

Capital Borrowing Strategy

33. The estimated borrowing requirement for 2011/2012 is calculated as follows:

	£m
Prudential Borrowing	16.8
Repayment of loans maturing	Nil
Less Minimum Revenue Provision	(11.8)
Total Borrowing	**5.0**
Finance leases*	1.0
Total	**6.0**

* Note Finance leases will only be used in the event that an options appraisal identified them as the most advantageous source of funding.

Based upon the prospects for interest rates outlined above, the Council's will give consideration to new borrowing in the following order of priority:-

i) As long term borrowing rates are expected to be higher than investment rates and look likely to be for the next couple of years or so all new external borrowing may be deferred in order to maximise savings in the short term. The running down of investments also has the added benefit of reducing exposure to interest rate and credit risk during the continued market turmoil. However, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing up the short term advantage of internal borrowing against potential long term costs if the opportunity is missed for taking market loans at long term rates which will be higher in future years.

ii) Temporary borrowing from the money markets or other local authorities.

iii) PWLB variable rate loans for up to 10 years.

iv) Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period following the announcement by the Chancellor to increase all PWLB rates by up to 1% following the Comprehensive Spending Review.

v) Short term PWLB rates are expected to be significantly cheaper than longer term borrowing therefore borrowing could be undertaken in the under 10 year period early on in the financial year when rates are expected to be at their lowest. This will also have the added benefit of spreading debt maturities away from a concentration in longer dated debt.

vi) If it was felt that there was a significant risk in a sharp fall in long and short term rates then long term borrowings will be postponed. If it was felt there was a significant risk of a sharp rise in long and short term rates then the portfolio position would be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

34. Delegated authority is sought for the Section 151 Officer to exercise the borrowing powers contained in the Local Government Act 2003 to manage the debt portfolio.

External versus internal borrowing

35. The revised Prudential Code now requires the Council to explain its policy on gross and net debt. The Council currently has gross debt of £279 million and net debt (after deducting cash balances) of £191 million. The next financial year is expected to see the Bank Rate continue at historically low levels. As borrowing rates are expected to be higher than investment rates this would indicate that value could best be obtained by avoiding new external borrowing (i.e. increasing the gross debt) and using internal cash balances to finance new capital expenditure. This is referred to as internal borrowing and would maximise short term savings.

36. However, by delaying unavoidable new external borrowing until later years when PWLB rates are forecast to be significantly higher will mean the potential for incurring extra long term costs.

37. The Council has examined the potential for undertaking early repayment of some external debt in order to reduce the difference between its gross and net debt positions. However, the introduction by the PWLB of significantly lower rates for repayments than for new borrowing means that large premiums would be incurred and such levels of premiums cannot be justified on value for money grounds.

38. Against this background caution will be adopted with the 2011/12 treasury operations. The Section 151 Officer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to Members at the next available opportunity.

Policy on borrowing in advance of need

39. The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

40. In determining whether borrowing will be undertaken in advance of need the Council will:-

- Ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need.
- Ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered.
- Evaluate the economic and market factors that might influence the manner and timing of any decision to borrow.
- Consider the merits and demerits of alternative forms of funding.
- Consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.
- Consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balance and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

Debt Rescheduling

41. The introduction of a differential in PWLB rates on 1 November 2007, which has now been compounded further since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has meant that large premiums would be incurred if debt restructuring is undertaken which cannot be justified on value for money grounds. However, interest rate savings may still be achievable through using LOBO's (Lenders Option Borrowers Option) loans and other market loans. Consideration will also be given to the potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates currently paid on debt. However, this will need careful consideration in the light of premiums that may be incurred by such a course of action. The proposals for debt rescheduling are a continuation of the existing policy and such transactions will only be undertaken:-

- in order to generate cash savings at minimum risk.
- to help fulfil the strategy set out above.
- in order to enhance the balance of the long term portfolio by amending the maturity profile and/or volatility of the portfolio.

Investment Strategy

42. The Council is required, under CIPFA's Treasury Managements Code of Practice, to formulate an Annual Investment Strategy (Appendix 2). This outlines the Council's approach to:-
    - Security of capital
    - Creditworthiness policy
    - Monitoring of credit ratings
    - Specified and Non Specified Investments
    - Temporary Investments

43. The Council's investment priorities are the security of capital and the liquidity of its investments. The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

44. The Council are asked to approve the Investment Strategy set out in Appendix 2.

Minimum Revenue Provision (MRP) Statement

45. In accordance with Statutory Instrument 2008 number 414 and new guidance issued by the Government under section 21 (1A) of the Local Government Act 2003 a statement on the Council's policy for its annual MRP needs to be approved before the start of the financial year. The Council are asked to approve the Minimum Revenue Provision Statement set out in Appendix 3.

Landsbanki Deposit Update

46. The claim for the £1 million deposit placed by Bridgnorth District Council with the Icelandic Bank, Landsbanki has been accepted as a priority claim by the Landsbanki Winding up Board. Latest information suggests that 95% of the deposit will be repaid in instalments starting in October 2011 to October 2018. However, an objection has been filed in respect of the decision by non-priority creditors such as bond holders and banks. Challenges to the decision will follow Icelandic legal processes. If unsuccessful parties wish to appeal the decision then this appeal is heard in the Icelandic Supreme Court. It is expected that the decision will be upheld but if the claims are classified as unsecured claims the expected recovery rate is around 38%.

Leasing

47. In the past the Council has used operating leases to finance the purchase of vehicles and equipment. The Section 151 Officer will assess the relative merits of operating and finance leases on a case by case basis and enter into the most advantageous. School's I.T equipment will continue to be internally financed by borrowing against a small fund set against school balances with school's repaying their borrowing over a period of 3 years.

Lending to Housing Associations

48. As previously approved by full Council, the Council has offered to lend funds to Shropshire Housing Ltd (which incorporates South Shropshire Housing Association and the Meres & Mosses Housing Association) and Severnside Housing at an agreed rate. In the current climate Housing Associations can find it difficult to obtain funding for new affordable housing and the Council is generating only a small amount of interest on revenue balances.

49. It has been agreed that the interest rate charged will depend on the period over which the loan is to be taken and that it will be linked to the applicable PWLB rate. It has been agreed to offer to lend up to £10 million to each of these Housing Associations in order to support the building of affordable housing and shared office accommodation in Shropshire. For security purposes, each loan will be secured against existing assets held by or owned by the Housing Association. If Shropshire Rural were to request a similar facility, for a smaller amount given the size of this local Housing Association, this could also be facilitated.

50. Officers have sought advice from Wragge & Co who has confirmed that the Council has the power to lend funds to Housing Associations under the Housing Act 1996 and have drawn up the legal documentation relating to the loan agreement.

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)

Treasury Management Practices

Treasury Strategy 2010/11 (Council February 2010)

Shropshire Council Capital Programme 2011/12 to 2015/16 (Cabinet 15 February 2011)

Revised MRP Statement (Council 10 December 2009)

Capital Monitoring Report December 2010 (Cabinet 15 February 2011)

Capital Programme 2006/07 & 2007/08 (Council 24 February 2006)

Capital Monitoring Report Quarter 2 2006/07 (Cabinet 15 November 2006)

Primary School Capital Programme Use of Capital Receipts/Prudential Borrowing (Council 19 December 2008)

William Brookes BSF One School Pathfinder Project (Council 18 July 2008)

Human Rights Act Appraisal

The recommendations contained in this report are compatible with the provisions of the Human Rights Act 1998

Environmental Appraisal
Impossible to Quantify

Community / Consultations Appraisal
N/A

Risk Management Appraisal

Compliance with the CIPFA Code of Practice on Treasury Management, the Council's Treasury Policy Statement and Treasury Management Practices and the Prudential Code for Capital Finance together with comprehensive and rigorous internal controls will enable the Council to manage the risk associated with Treasury Management activities and the potentials for financial loss.

Cabinet Member: Mike Owen, Portfolio Holder

Appendices:

1 – Prudential Indicators

2 – Council's Annual Investment Strategy

3 – Minimum Revenue Provision Policy Statement

Prudential Indicators

Prudential Indicator	**2010/11 Estimate**	**2011/12 Estimate**	**2012/13 Estimate**	**2013/14 Estimate**
	%	**%**	**%**	**%**
Non HRA ratio of financing costs to net revenue stream	10.5	11.5	12.3	12.2
HRA ratio of financing costs to HRA net revenue stream	15.4	14.9	14.7	14.4

Prudential Indicator	**2010/11 Estimate**	**2011/12 Estimate**	**2012/13 Estimate**	**2013/14 Estimate**
	%	**%**	**%**	**%**
Non HRA ratio of financing costs (net of investment income) to net revenue stream	10.1	11.1	11.8	11.7

Prudential Indicator	**2011/12**	**2012/13**	**2013/14**
Estimates of impact of Capital Investment decisions in the present capital programme	**£ p**	**£ p**	**£ p**
Cost of capital investment decisions funded from re-direction of existing resources (Band D, per annum)	23.20	34.02	36.46
Cost of capital investment decisions funded from increase in council tax (Band D, per annum)	0	0	0
Cost of capital investment decisions funded from an increase in average housing rents per week	0	0	0
Total	**23.20**	**34.02**	**36.46**

Prudential Indicator	**2010/11 Estimate**	**2011/12 Estimate**	**2012/13 Estimate**	**2013/14 Estimate**
Net Borrowing & Capital Financing Requirement:	**£ m**	**£ m**	**£ m**	**£ m**
Non HRA Capital Financing Requirement	293	299	292	285
Gross Borrowing	293	298	290	280
Investments	90	90	90	90
Net Borrowing	203	208	200	190
HRA Capital Financing Requirement	1.2	1.2	1.3	1.3

Prudential Indicator	**2009/10 Actual**	**2010/11 Estimate**	**2011/12 Estimate**	**2012/13 Estimate**	**2013/14 Estimate**
	£ m	**£ m**	**£ m**	**£ m**	**£ m**
Non HRA Capital expenditure	77	89	73	33	28
HRA Capital expenditure	1	6	4	3	3

Contact: Graham Chidlow on (01743) 252072

Prudential Indicator	**2011/12**	**2012/13**	**2013/14**
External Debt	**£ m**	**£ m**	**£ m**
Authorised Limit for External Debt:			
Borrowing	412	408	392
Other long term liabilities (PFI)	41	41	39
Total	**453**	**449**	**431**

Prudential Indicator	**2011/12**	**2012/13**	**2013/14**
External Debt	**£ m**	**£ m**	**£ m**
Operational Boundary:			
Borrowing	348	350	338
Other long term liabilities (PFI)	35	35	34
Total	**383**	**385**	**372**

Prudential Indicator	**2009/10 Actual**	**2010/11 Estimate**
External Debt	**£ m**	**£ m**
Borrowing	280	293
Other long term liabilities (PFI)	20	25
Total	**300**	**318**

Prudential Indicator number 13 - The Local Authority has adopted the CIPFA Code of Practice for Treasury Management in Public Services. Shropshire Council adopted the revised Code in February 2010.

Prudential Indicator	**2011/12**	**2012/13**	**2013/14**
Borrowing Limits			
	£ m	**£ m**	**£ m**
Upper Limit for Fixed Interest Rate Exposure	348	350	338
Upper Limit for Variable Interest Rate Exposure	174	175	169
Lower Limit for Fixed Interest Rate Exposure	174	175	169
Lower Limit on Variable Interest Rate Exposure	0	0	0

Prudential Indicator	**2011/12**	**2012/13**	**2013/14**
Investment Limits			
	£ m	**£ m**	**£ m**
Upper Limit for Fixed Interest Rate Exposure	200	200	200
Upper Limit for Variable Interest Rate Exposure	200	200	200
Lower Limit for Fixed Interest Rate Exposure	0	0	0
Lower Limit on Variable Interest Rate Exposure	0	0	0

Prudential Indicator	Upper Limit	Lower Limit
Maturity Structure of Fixed Rate Borrowing During 2011/12 **	**%**	**%**
Under 12 months	15	0
12 months & within 24 months	15	0
24 months & within 5 years	45	0
5 years & within 10 years	75	0
10 years & above	100	50

**** Internal limit is to have no more than 15% of total outstanding debt maturing in any one financial year.**

Prudential Indicator	2011/12	2012/13	2013/14
Investment Limits			
	£m	£m	£m
Upper Limit for Total Principal Sums Invested for over 364 days:			
Externally Managed (if appointed in 2011/2012)	30	30	30
Internally Managed	40	40	40

Appendix 2

The Council's Annual Investment Strategy

Under the revised CIPFA's Treasury Management Code of Practice 2009, the Council is required to formulate a strategy each year regarding the investment of its revenue funds and capital receipts. From 2004-05 onwards the requirements of the Treasury Management Code have been supplemented by guidance from the Communities and Local Government (CLG) and any revisions to that guidance. Authorities are required to take the guidance into account under the terms of section 12 of the Local Government Act 2003. In addition, the Council has regard to the Audit Commission's report on Icelandic investments.

The income and expenditure flow of the Council is such that funds are temporarily available for investment. Under the Annual Investment Strategy the Council may use for the prudent management of its treasury balances any of the investments highlighted under the headings of **Specified Investments** and **Non-Specified Investments** as detailed on the attached table (Appendix 2A).

Creditworthiness Policy

The Council uses the creditworthiness service provided by its treasury advisor, Sector Treasury Services. Previously the Council set minimum long term, short term, individual and support credit ratings for its specified and non specified investments based on information supplied by Sector from two of the three credit rating agencies Fitch and Moody's. However, following the problems with Icelandic Banks and the issue of the revised CIPFA Code of Practice on Treasury Management the Council is now required to use ratings from all three credit rating agencies and must not solely rely on an institutions credit rating when considering placing an investment. In light of this, Sector has been progressively enhancing their service and now uses a sophisticated modelling approach with credit ratings from all three rating agencies Fitch, Moody's and Standard and Poor's. In addition, in line with the revised Treasury Management Code of Practice 2009, it does not rely solely on the current credit ratings of counterparties but also uses the following overlays:-

- Credit watches and credit outlooks from credit rating agencies.
- Credit Default Swap (CDS) spreads to give an early warning of likely changes in credit ratings.
- Sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit watches, credit outlooks and CDS spreads in a weighted scoring system for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration of investments and are therefore referred to as durational bands. The Council is satisfied that this service now gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.

The selection of counterparties with a high level of creditworthiness will be achieved by a selection of institutions down to a minimum durational band with Sector's weekly credit list of worldwide potential counterparties. The Council will therefore use counterparties within the following durational bands:-

- Yellow – 5yrs e.g. UK Gilts, Collateralised Deposits
- Purple - 2yrs (Council currently has maximum of 1 year)
- Blue - 1 year (only applies to nationalised or part nationalised UK Banks)
- Orange - 1 year
- Red - 6 months
- Green - 3 months
- No colour – not to be used

The Sector creditworthiness service uses ratings from all three agencies, but by using a scoring system, does not give undue over reliance to just one agency's ratings.

Monitoring of Credit Ratings

All credit ratings will continue to be monitored continuously and formally updated monthly. The Council is alerted to interim changes in ratings by Sector Treasury Services.

If a counterparty's or investment scheme's rating is downgraded with the result that it no longer meets the Council's minimum criteria, the further use of that counterparty will be withdrawn immediately. If a counterparty is upgraded so that it fulfils the Councils criteria, its inclusion will be considered for approval by the S151 Officer.

In addition to credit ratings the Council will be advised of information in movements in CDS against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in the downgrade of an institution or the removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition, the Council will monitor the financial press and also use other market data and information e.g. information on government support for banks and the credit ratings of that government support.

Country Limits

It is recommended that the Council will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies). However, following the problems with Icelandic Banks lending is currently restricted to the UK only which has the highest possible sovereign credit rating of AAA. The S151 Officer has delegated authority to revert back to placing investments in countries with a minimum sovereign credit rating of AA- in line with Sector's revised creditworthiness policy if required.

Security of Capital

Following the market turmoil over the last few years and problems with Icelandic Banks, the Council's current policy is to not place investments with any Foreign banks or AAA rated Money Market Funds. Lending to Foreign banks which comply with Sectors creditworthiness policy or AAA rated Money Market Funds may be considered again but only with the express approval of the Head of Finance.
In addition, in order not to solely rely on an institutions credit ratings there have also been a number of other developments which require separate consideration and approval for use:

Nationalised and Part Nationalised banks in the UK effectively take on the creditworthiness of the Government itself i.e. deposits made with them are effectively being made to the Government therefore they have been assigned an F1+ short term rating and a support rating of 1 both of which are the highest ratings possible. However, as they are no longer separate institutions in their own right the credit ratings agencies cannot assign them an individual rating for their stand alone financial strength. For this reason Lloyds TSB, Royal Bank of Scotland (RBS) and National Westminster Bank which are part of the RBS Group are included on the approved counterparty list.

A UK banking system support package (implicit guarantee) has been put in place to ensure the security of the UK banking system by supporting the following banks with a £500 billion support package:-

- Abbey (Now Santander UK)
- Barclays
- Halifax Bank of Scotland (HBOS)
- Lloyds TSB
- HSBC
- Nationwide Building Society
- Royal Bank of Scotland
- Standard Chartered Bank

Although the UK Government has not given a blanket guarantee on all deposits placed with these institutions this additional support provides extra security meaning that credit ratings alone are not relied upon. With the exception of Standard Chartered Bank and HBOS as they have now been taken over by the Lloyds Banking Group all of the institutions listed above meet the Council's creditworthiness policy so can therefore be included on the approved lending list.

Blanket (explicit) Guarantees on all deposits have been given by some countries in order to support their banking system e.g. Ireland and Singapore. Therefore, the country's sovereign rating may take precedence over the individual credit ratings for the banks covered by that guarantee. For this reason, in addition to credit ratings our treasury advisor now also include each country's sovereign ratings on their monthly credit rating lists. Other countries are also providing implicit guarantees for their banking systems. The US, countries within the EU and Switzerland are currently providing major support packages to their banking systems. Again due to this additional government support the authority may consider placing deposits with institutions covered by these guarantees following approval from the S151 Officer.

Local Authorities are not credit rated but where the investment is a straightforward cash loan, statute suggests that the credit risk attached to local authorities is an acceptable one (Local Government Act 2003 s13). Local Authorities are therefore included on the approved list.

The total permitted investment in any one organisation at any one time varies with the strength of the individual credit rating. For the highest rated and Part Nationalised Institutions the maximum amount is currently limited to £30m. Any changes to the maximum limit must be approved by the S151 Officer.

DCLG Investment Guidance

Guidance from the DCLG requires Councils to give priority to the security and liquidity of investments over yield whilst still aiming to provide good returns. This is in line with the Council's current practice and it is recommended that the policy should be reaffirmed.

The guidance also requires Councils to categorise their investments as either "specified" or "non-specified" investments.

(i) Specified Investments

Specified investments are deemed as "safer" investments and must meet certain conditions, ie they must :-

- be denominated in sterling
- have less than 12 months duration
- not constitute the acquisition of share or loan capital

- either: be invested in the UK government or a local authority
or a body or investment scheme with a "high" credit quality.

The Council is required to specify its creditworthiness policy and how frequently credit ratings should be monitored. It must also specify the minimum level of such investments.

Of the investments currently authorised by the Council, deposits in the Debt Management Office Account and with other Local Authorities automatically qualify as specified investments as they are of less than 12 months duration and are denominated in sterling.

The classification of the other investments is dependent on the counterparty having high credit quality in line with Sector's creditworthiness policy. The Council is alerted to any changes in an institutions credit rating by Sector Treasury Services.

(ii) Non Specified Investments

The Council is required to look at non-specified investments in more detail. It must set out:

- procedures for determining which categories of non-specified investments should be used
- the categories deemed to be prudent
- the maximum amount to be held in each category

The Strategy must also set out procedures for determining the maximum period for committing funds.

It is recommended that the following procedure be adopted for determining which categories of non-specified investments should be used:

- the Cabinet/Council should approve categories on an annual basis
- advice should be provided by the S151 Officer
- priority should be given to security and liquidity ahead of yield

It is recommended that for specified investments the range of maximum limits is set between £10m and £30m for the internal treasury team. For non specified investments it is recommended that the limit for the internal treasury team should be restricted to £40m of the total investment portfolio. Any changes to the maximum limits must be approved by the S151 Officer.

Temporary Investment Strategy

The next financial year is expected to see investment rates continue to be at historically low levels. The Bank Rate has remained at 0.50% since March 2009. It is not expected to rise to 0.75% until December 2011. It is expected to end the financial year at 1.00% following a further 0.25% rise in March 2012. There is a downside risk to these forecasts if recovery from recession proves to be weaker and slower than currently expected. This view is based on the latest forecasts obtained by the Authority's treasury advisor, Sector Treasury Services.

If an external fund manager is appointed in 2011/2012 they would also have to adhere to the authorised specified and non-specified investments on the attached table. They would also have to comply with the Council's Annual Investment Strategy and their agreement must stipulate guidelines and other limits in order to contain and control risk.

Short term cash flow requirements limit the scope for longer term investments for the in-house treasury team, but the market is continually monitored for opportunities to lock in to higher, longer term rates in order to bring some stability to the returns going forward and add value. However, based on the interest rate assumptions outlined above, we do not expect to lock into longer term deals while investment rates are down at historically low levels unless exceptionally attractive rates are available which make longer term deals worthwhile.

For the cash flow generated balances, we will seek to utilise instant access accounts and short dated deposits (1-3 months) in order to benefit from the compounding of interest.

The present strategy is to diversify investments so as to spread risk over a range of investment types and periods and provide the opportunity to enhance returns. Due to the current lending restrictions in place diversification has been some what reduced due to the reduction in the number of institutions which we can lend to however, by taking this course of action the credit risk has been reduced. The current portfolio is set out in paragraph 29 of the Treasury Strategy 2011/12 report. Performance of the in-house operation will continue to be monitored on a quarterly basis by your officers in conjunction with the treasury advisor.

In December 2007, Council approved that dollar denominated deposits could be held, on behalf of West Mercia Supplies (WMS) only. This was so the cost of ordering goods from overseas could be minimised. The schedule of specified/non specified investments allows WMS funds only to be placed in US dollars. No Council funds are permitted to be placed in US dollars.

All investments will continue to be made in accordance with the Local Government Act 2003, and with those institutions on the authorised lending list. The credit status of institutions on the approved list is monitored continuously.

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

Policy on the use of external service providers

The Council currently uses Sector Treasury Services as its external treasury management advisers. The Council recognises that the responsibility for treasury management decisions remains with the Council at all times and will ensure the undue reliance is not placed upon our external service providers. The Council also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented and subjected to review.

Scheme of Delegation

Full Council

- Approval of Treasury Strategy.
- Receiving and reviewing reports on treasury management policies, practices and activities including the Annual Treasury Report and Mid Year Report.
- Budget consideration and approval

Cabinet

- Receiving & reviewing Treasury Strategy, Mid Year Report, Annual Treasury Report and Quarterly Treasury Management Update Reports

Audit Committee

- Reviewing the treasury management policy and procedures and making recommendations to the responsible body.
- Receiving & reviewing Treasury Strategy, Mid Year Report, Annual Treasury Report.

Role of the Section 151 Officer

The role of the S151 Officer in relation to treasury management is as follows:-

- Recommending clauses, treasury management policy/practices for approval, reviewing the same regularly and monitoring compliance.
- Approval of segregation of responsibilities.
- Approval of the Treasury Policy Statement and Treasury Management Practices.
- Submitting regular treasury management policy reports.
- Submitting budgets and budget variations.
- Receiving and reviewing management information reports.
- Reviewing the performance of the treasury management function.
- Ensuring the adequacy of treasury management resources and skills and the effective division of responsibilities within the treasury management function.
- Ensuring the adequacy of internal audit and liaising with external audit.
- Recommending the appointment of external service providers.

Pension Fund Cash

This Council will comply with the requirements of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, which were implemented on 1st January 2010, and from 1st April 2010 will not pool pension fund cash with its own balances for investment purposes. Any investments made by the Pension Fund directly with the Council after 1st April 2010 will comply with the requirements of SI 2009 No 393.

LOCAL GOVERNMENT INVESTMENTS (England)

SPECIFIED INVESTMENTS

All investments listed below must be sterling-denominated.

Investment	Share/ Loan Capital?	Repayable/ Redeemable within 12 months?	Security / Minimum Credit Criteria	Capital Expenditure?	Circumstance of use	Maximum period
Term deposits with the UK government (e.g. DMO Account) or with local authorities (i.e. local authorities as defined under Section 23 of the 2003 Act) with maturities up to 1 year	No	Yes	High security although LAs not credit rated.	NO	In-house and by external fund manager	1 year
Term deposits with credit-rated deposit takers (banks and building societies), including callable deposits, with maturities up to 1 year	No	Yes	Yes – Minimum colour band green	NO	In-house and by external fund manager	1 year
Certificates of Deposit issued by credit-rated deposit takers (banks and building societies) covered by the implicit UK Government guarantee: up to 1 year. *Custodial arrangement required prior to purchase*	No	Yes	Yes – Minimum colour band green	NO	In house buy and hold and External fund managers	1 year
Certificates of Deposit issued by credit-rated deposit takers (banks and building societies) NOT covered by the implicit UK Government guarantee: up to 1 year. *Custodial arrangement required prior to purchase*	No	Yes	Yes – Minimum colour band green	NO	In house buy and hold and External fund managers	1 year
Banks nationalised by high credit rated (sovereign rating) countries	No	Yes	Minimum Sovereign Rating AA-	No	In house and external fund managers	1 year

Investment	Share/ Loan Capital?	Repayable/ Redeemable within 12 months?	Security / 'High' Credit Rating criteria	Capital Expenditure?	Circumstance of use	Maximum period
Banks & Building Societies supported by the implicit UK Government package	**No**	**Yes**	**Yes – Minimum colour band green**	**No**	**In House and external fund managers**	**1 year**
UK Nationalised & Part Nationalised banks	**No**	**Yes**	**Yes – Minimum colour band green**	**No**	**In House and external managers**	**1 year**
Government guarantee (explicit) on all deposits by high credit rated (sovereign rating) countries	**No**	**Yes**	**Yes – Minimum Sovereign Rating AA-**	**No**	**In house and external fund managers**	**1 year**
Bonds issued by multilateral development banks (Euro Sterling Bonds as defined in SI 2004 No 534) or issued by a financial institution guaranteed by UK government with maturities under 12 months. *Custodial arrangement required prior to purchase* Gilt Funds and Bond Funds	No No	Yes Yes	AAA AAA	NO NO	In-House on a buy and hold basis after consultation/advice from Sector also for use by External fund manager In House and by external fund managers	1 year 1 year
Gilts : up to 1 year *Custodial arrangement required prior to purchase*	No	Yes	Govt-backed UK Sovereign Rating	NO	In House on a buy and hold basis and for trading by external fund manager subject to the guidelines and parameters agreed with them	1 year

Investment	Share/ Loan Capital?	Repayable/ Redeemable within 12 months?	Security / 'High' Credit Rating criteria	Capital Expenditure?	Circumstance of use	Maximum period
Money Market Funds & Government Liquidity Funds	No	Yes	Yes AAA rated & UK sovereign rating	NO	In-house and by external fund managers subject to the guidelines and parameters agreed with them	the period of investment may not be determined at the outset but would be subject to cash flow and liquidity requirements. Deposits are repayable at call.
Treasury bills [*Government debt security with a maturity less than one year and issued through a competitive bidding process at a discount to par value*] *Custodial arrangement required prior to purchase*	No	Yes	Govt-backed UK Sovereign Rating	NO	In House or external fund managers subject to the guidelines and parameters agreed with them	1 year

Monitoring of credit ratings:
All credit ratings will be monitored continuously and formally updated on a monthly basis. If a counterparty or investment scheme is downgraded with the result that it no longer meets the Council's minimum credit criteria, the use of that counterparty / investment scheme will be withdrawn.
Any intra-month credit rating downgrade which the Council has identified that affects the Council's pre-set criteria will also be similarly dealt with.

LOCAL GOVERNMENT INVESTMENT (England)

NON-SPECIFIED INVESTMENTS

All investments listed below must be sterling-denominated (with the exception of the WMS US dollar account).

Investment	(A) Why use it? (B) Associated risks?	Share/ Loan Capital?	Repayable/ Redeemable within 12 months?	Security / Minimum credit rating	Capital Expen-diture?	Circumstance of use	Max % of overall investments	Maximum maturity of investment
Certificates of Deposit with credit rated deposit takers (banks and building societies) or banks and building societies covered by the implicit UK Government guarantee with maturities greater than 1 year *Custodial arrangement required prior to purchase*	(A) (i) Although in theory tradable, are relatively illiquid. (B) (i) 'Market or interest rate risk' : Yield subject to movement during life of CD which could negatively impact on price of the CD.	No	Yes	UK Sovereign rating	NO	In house on a buy and hold basis after consultation/advice from Sector & external cash fund manager(s) subject to the guidelines and parameters agreed with them.	50%	*Suggested limit :* Average duration in the portfolio not to exceed 5 years
Collateralised deposit	Deposits are backed by collateral of AAA rated local authority	No	Yes	UK Sovereign rating	No	In house & External Manager	25%	*5 years*
UK government gilts with maturities in excess of 1 year *Custodial arrangement required prior to purchase*	(A) (i) Excellent credit quality. (ii)Very Liquid. (iii) If held to maturity, known yield (rate of return) per annum ~ aids forward planning. (iv) If traded, potential for capital gain through appreciation in value (i.e. sold before maturity) (v) No currency risk (B) (i) 'Market or interest rate risk' : Yield subject to movement during life of sovereign bond which could negatively impact on price of the bond i.e. potential for capital loss.	No	Yes	UK Sovereign rating	NO	In house on a buy & hold basis following advice from Sector and for trading by external cash fund manager subject to the guidelines and parameters agreed with them	100%	*Suggested limit :* Average duration in the portfolio not to exceed 5 years

Investment	(A) Why use it? (B) Associated risks?	Share/ Loan Capital?	Repayable/ Redeemable within 12 months?	Security / Minimum credit rating **	Capital Expen-diture?	Circumstance of use	Max % of overall investments	*Maximum maturity of investment*
Term deposits with UK government, other Local Authorities institutions covered by the implicit UK Government guarantee and credit rated deposit takers (banks and building societies) including callable deposits with maturities greater than 1 year	(A) (i) Certainty of rate of return over period invested. (ii) No movement in capital value of deposit despite changes in interest rate environment. (B) (i) Illiquid : as a general rule, cannot be traded or repaid prior to maturity. (ii) Return will be lower if interest rates rise after making the investment. (iii) Credit risk : potential for greater deterioration in credit quality over longer period	No	No	Minimum colour band purple	NO	In-House For trading by external cash fund manager subject to the guidelines and parameters agreed with them	£40 million 50%	*Suggested limit:* 2 years
Sovereign bond issues ex UK Government Gilts: any maturity **Bonds issued by multilateral development banks** (Euro-Sterling Bonds) or issued by a financial institution guaranteed by UK government Custodial arrangement required prior to purchase	(A) (i) Excellent credit quality. (ii) Liquid. (iii) If held to maturity, known yield (rate of return) per annum – aids forward planning. (iv) If traded, potential for capital gain through appreciation in value (i.e. sold before maturity) (v) No currency risk (B) (i) "Market or interest rate risk" : Yield subject to movement during life of sovereign bond which could negatively impact on price of the bond i.e. potential for capital loss (A) (i) Excellent credit quality. (ii) Liquid. (iii) If held to maturity, known yield (rate of return) per annum – aids forward planning. (iv) If traded, potential for capital gain through appreciation in value (i.e. sold before maturity) (v) No currency risk (B) (i) "Market or interest rate risk" : Yield subject to movement during life of bond which could negatively impact on price of the bond i.e. potential for capital loss	No Yes	Yes Yes	AAA AAA	No No	For trading by external cash fund manager only subject to the guidelines and parameters agreed with them In house on a buy and hold basis after consultation/advice from Sector. Also for use by external fund managers	50% 10% 50%	*Suggested limit:* 5 years 5 years

Investment	(A) Why use it? (B) Associated risks?	Share/ Loan Capital?	Repayable/ Redeemable within 12 months?	Security / Minimum credit rating **	Capital Expen-diture?	Circumstance of use	Max % of overall investments	*Maximum maturity of investment*
Corporate Bonds	(A) (i) Excellent credit quality. (ii) Liquid. (iii) If held to maturity, known yield (rate of return) per annum – aids forward planning. (iv) If traded, potential for capital gain through appreciation in value (i.e. sold before maturity) (v) No currency risk (B) (i) "Market or interest rate risk" : Yield subject to movement during life of sovereign bond which could negatively impact on price of the bond i.e. potential for capital loss	Yes	Yes	Minimum Sovereign rating AA-	Yes	To be used by external fund managers only	50%	*Suggested limit:* *5 years*
US Dollar Deposits (WMS Only)	US dollar account to be utilised as a part of West Mercia Supplies prudent management of income and expenditure, ensuring that ongoing US dollar commitments can be hedged, thus extinguishing any adverse risk of exposure to movements in the exchange rate and guaranteeing a known cashflow for West Mercia Supplies. The account is only to be used for this purpose and not for the purpose of speculative or trading transactions.	No	Yes	Minimum Colour band green	No	West Mercia Supplies Only	N/A	*3 Months*

The Council's Annual Minimum Revenue Provision Statement

Statutory Requirements

The Council is required by statue to set aside a minimum revenue provision (MRP) to repay external debt. The calculation of the minimum revenue provision (MRP) is as per the *Local Authority (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 [SI 2008/414].* In the new regulation 28, detailed rules are replaced with a simple duty for an authority to make an amount of MRP which it considers to be "prudent".

The broad aim of a prudent provision is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant. The guidance includes four options (and there are two alternatives under Option three) for the calculation of a prudent provision.

There is no requirement to charge MRP where the Capital Financing Requirement (CFR) is nil or negative at the end of the preceding financial years. There is also no requirement to charge MRP on the Housing Revenue Account share of the CFR.

The legislation recommends that before the start of each financial year the Council prepares a statement of its policy on making MRP in respect of that financial year and submits it to the Full Council for approval.

Policy for calculation of Prudent Provision

The options for the calculation of a prudent Provision are detailed in appendix 3A to this report. In line with previous years the Council proposes to use option one, regulatory method and option three (a), asset life method – equal instalment method.

Regulatory Method

For debt which is supported by the Government through the RSG system, MRP will continue to be calculated in accordance with the former regulations 28 and 29 of the 2003 Regulation. Adjustment "A" (variance between the credit ceiling and the capital financing requirement as at 1 April 2004) will continue to be given the value attributed to it in the financial year 2004/05. Authorities can also continue to take advantage of the commutation adjustment in the former regulation 29.

MRP is calculated using opening Capital Financing Requirement which is adjusted for new supported capital expenditure, adjustment "A", non Shropshire Council (pre-1998 LGR reorganisation) debt and the MRP for the previous year. MRP is calculated as 4% of this adjusted total. This is then reduced by the value of the commutation adjustment for that financial year.

This option reduces the Capital Financing Requirement by adjustment "A" which reduces the MRP charged to revenue each year. This is allowable in accordance with the regulations.

Asset Life Method – Asset Life method

For new borrowing under the Prudential system for which no Government support is being given and is therefore self-financed (unsupported borrowing) the MRP has been calculated in accordance with option three Asset Life Method. Option three is to make provision over the estimated life of the asset for which the borrowing is undertaken.

Freehold land cannot properly have a life attributed to it, so for the purposes of Option three it should be treated as equal to a maximum of 50 years. But if there is a structure on the land which the authority considers to have a life longer than 50 years, that same life estimate may be used for the land.

To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

This method is a straight forward calculation of MRP for unsupported borrowing which calculates MRP based on asset life.

As with option one, provision for debt under Option three will normally commence in the financial year following the one in which the expenditure is incurred. But the guidance highlights an important exception to the rule. In the case of a new asset, MRP would not have to be charged until the asset came into service and would begin in the financial year following the one in which the asset became operational. This “MRP holiday” would be perhaps two or three years in the case of major projects, or possibly longer for some complex infrastructure schemes, and could make them more affordable. The Council does not have any unsupported borrowing that falls into this area at present.

The authority can still make voluntary extra provision for MRP in any year.

2011/12 Annual MRP Statement

Appendix 3B provides the MRP statement for the 2011/12 financial year.

Capital Receipts set aside

The current regulations, Local Authority (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 [SI 2008/414] state that the minimum revenue provision is calculated using the previous year’s closing Capital Financing Requirement for supported borrowing.

In 2009/10 Shropshire Council got DCLG approval to allow the new council to voluntarily set aside capital receipts as at 1st April 2009 to reduce the CFR and consequently reduce the MRP charge for 2009/10. This approach was discussed with our Treasury Advisors and External Auditors and was approved by Members in a report to Council in December 2009.

As the extent of new borrowing is not subject to any limitation the sum of capital receipts set aside are still available to support capital expenditure in future years. This will increase the CFR to its previous level and the MRP charge in future years will increase, but not beyond the level had the saving not been generated in 2009/10. Thus the saving in MRP is therefore temporary, albeit very helpful to the short-term financial position.

As the full level of capital receipts set aside were not required to finance capital expenditure in 2009/10, a balance was retained as set aside as at 31st March 2010 to enable a further MRP saving in 2010/11. In the 2011/12 MRP Statement it has been assumed all the capital receipts retained as set aside as at 31st March 2010 to reduce the CFR will be offset by an increase in the CFR in 2010/11 from capital expenditure incurred in 2010/11. In the event that the level of capital expenditure in 2010/11 to be financed from the capital receipts set aside is below the level of capital receipts set aside, it is proposed to retain the balance in capital receipts as set aside in order to achieve a further MRP saving in 2011/12.

Appendix 3A: Options for Prudent Provision

Option 1: Regulatory Method (Supported borrowing)

MRP is equal to the amount determined in accordance with the former regulations 28 and 29 of the 2003 Regulations, as if they had not been revoked by the 2008 Regulations. For the purposes of that calculation, the Adjustment A should normally continue to have the value attributed to it by the authority in the financial year 2004-05. However, it would be reasonable for authorities to correct any perceived errors in Adjustment A, if the correction would be in their favour.

Option 2: CFR Method (Supported borrowing)

MRP is equal to 4% of the non-housing CFR at the end of the preceding financial year without any adjustment for Adjustment A, or certain other factors which were brought into account under the previous statutory MRP calculation.

Option 3: Asset Life Method (Unsupported borrowing)

Where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, MRP is to be determined by reference to the life of the asset. There are two main methods by which this can be achieved, as described below. Under both variations, authorities may in any year make additional voluntary revenue provision, in which case they may make an appropriate reduction in later years' levels of MRP.

(a) Equal instalment method

MRP is the amount given by the following formula:

$$\frac{A - B}{C}$$

Where:
A is the amount of the capital expenditure in respect of the asset financed by borrowing or credit arrangements
B is the total provision made before the current financial year in respect of that expenditure
C is the inclusive number of financial years from the current year to that in which the estimated life of the asset expires.

For the purpose of the above formula in the initial year of making the MRP the variable "C" should be given the maximum values set out in the following table:

Expenditure Type	Maximum value of "C" in initial year
Expenditure capitalised by virtue of a direction under s16(2)(b)	"C" equals 20 years
Regulation 25(1)(a) Expenditure on computer programs	"C" equals the value it would have for computer hardware
Regulation 25(1)(b) Loans and grants towards capital expenditure by third parties	"C" equals the estimated life of the assets in relation to which the third party expenditure is incurred
Regulation 25(1)(c) Repayment of grants and loans for capital expenditure	"C" equals 25 years, or the period of the loan, if longer
Regulation 25(1)(d) Acquisition of share or loan capital	"C" equals 20 years
Regulation 25(1)(e)	"C" equals the estimated life of the assets

Expenditure on works to assets not owned by the authority	
Regulation 25(1)(ea) Expenditure on assets for use by others	“C” equals the estimated life of the assets
Regulation 25(1)(f) Payment of levy on Large Scale Voluntary Transfers (LSVTs) of dwellings	“C” equals 25 years

(b) Annuity method
MRP is the principal element for the year of the annuity required to repay over the asset life the amount of capital expenditure financed by borrowing or credit arrangements. The authority should use an appropriate interest rate to calculate the amount. Adjustments to the calculation to take account of repayment by other methods during the repayment period (e.g. by the application of capital receipts) should be made as necessary.

Option 4: Depreciation Method (Unsupported borrowing)
MRP is to be equal to the provision required in accordance with depreciation accounting in respect of the asset on which expenditure has been financed by borrowing or credit arrangements. This should include any amount for impairment chargeable to the Income and Expenditure Account.

For this purpose standard depreciation accounting procedures should be followed, except in the following respects.

(a) MRP should continue to be made annually until the cumulative amount of such provision is equal to the expenditure originally financed by borrowing or credit arrangements. Thereafter the authority may cease to make MRP.
(b) On disposal of the asset, the charge should continue in accordance with the depreciation schedule as if the disposal had not taken place. But this does not affect the ability to apply capital receipts or other funding sources at any time to repay all or part of the outstanding debt.
(c) Where the percentage of the expenditure on the asset financed by borrowing or credit arrangements is less than 100%, MRP should be equal to the same percentage of the provision required under depreciation accounting.

Basis of options

Supported Borrowing – The total Adjustment A for the Council is £4.45m (including previous District debt), thus by using option 1 Regulatory method the MRP charge is reduced by £178,000 per annum.

Unsupported Borrowing – As the Council policy is to calculate depreciation based on asset life option 3A and 4 would result in the same MRP charge (i.e. for a £1m borrowed to finance an asset with an estimated life of 25 years the annual MRP charge would be £40,000 per annum). If option 3B was used the MRP charge would be lower in the earlier years, but increase annually each year. Borrowing £1m over 25 year at 6% the MRP charge would increase from £18,000 in year 1 to £74,000 in year 25, with compensating adjustments to the interest payment, thus there would be no saving for the Council.

Appendix 3B: Minimum Revenue Provision Statement 2011/12

	£
<u>Supported Borrowing – Option 1</u>	
General Fund	
Closing CFR 2009/10	235,793,769.06
Add SCE (R) 2010/11	19,672,370.00
Add use of capital receipts voluntarily set aside (applied 2010/11)	23,154,818.60
	278,620,957.66
Less Adjustment "A"	(2,065,478.00)
Less LGR (98) Debt	(762,973.00)
	275,792,506.66
Less MRP 2010/11	(9,465,675.12)
CFR for Supported Borrowing MRP Calculation	**266,326,831.54**
Add back Adjustment "A"	2,065,478.00
Add back LGR (98) Debt	762,973.00
	269,155,282.54
District inherited debt:	
OBC – Closing 2008/09 CFR	4,686,626.89
NSDC – Closing 2008/09 CFR	657,683.34
	5,344,310.23
Closing CFR 31/03/11 – Supported Borrowing (GF)	**274,499,592.77**
Housing Revenue Account	
District inherited debt: OBC – Closing 2008/09 & SC 2010/11 CFR	**1,244,619.49**
Closing CFR 31/03/11 – Supported Borrowing (GF&HRA)	**275,744,212.26**
<u>Unsupported Supported Borrowing – Option 3</u>	
Unsupported Borrowing brought forward	13,282,579.19
Add prudential borrowing 2010/11	3,730,000.00
Less MRP – Previous year	(540,749.52)
	16,471,829.66
District inherited debt: NSDC – Closing 2010/11 CFR	**864,146.42**
Closing CFR 31/03/10 – Unsupported Supported Borrowing	**17,335,976.09**
Closing CFR (GF&HRA) 31/03/11	**293,080,188.35**
<u>Summary MRP</u>	
MRP 2011/12 at 4% of above (Option 1)	10,653,073.26
LGR (98) Debt MRP (Option 1)	153,175.00
Unitary inherited – OBC & NSDC (Option 1)	118,532.18
Prudential Borrowing MRP (Option 3)	825,229.52
Unitary inherited Prudential Borrowing MRP – NSDC (Option 3)	48,413.32
Total MRP 2011/12	**11,798,423.29**