AGENDA ITEM No. 8.

NORTH LANARKSHIRE COUNCIL

REPORT

To: POLICY & RESOURCES (FINANCE) SUB-COMMITTEE		Subject: TREASURY MANAGEMENT STRATEGY 2007/08 AND PRUDENTIAL INDICATORS 2007/2008 TO 2009/2010
From: DIRECTOR OF FINANCE		
Date: 11 January, 2007	Ref: JV/KH/JQ	

1. Introduction

1.1. This report fulfils the key requirements of the Local Government Act 2003 in that it:

- Outlines the Treasury Management Strategy for 2007/2008 in accordance with the CIPFA Code of Practice on Treasury Management
- Reports on the prudential indicators as required by the CIPFA Prudential Code for Capital Finance in Local Authorities

2. Treasury Strategy

2.1. The Treasury Strategy Statement 2006/07 approved by Committee on 21 March 2006, set out the Treasury Management policies, practices and activities undertaken by the Finance Department in compliance with the Code of Practice. In addition, the Treasury Strategy describes the Prudential Treasury Indicators introduced and monitored on a regular basis to demonstrate that the Council's investment plans are managed within a sound financial environment. This report now updates the strategy for year 2007/08.

3. Prudential Indicators

3.1. The Prudential Code for Capital Finance in Local Authorities was introduced in April 2004 and brought about a change to capital spending controls from 1st April 2004. From that date, councils have freedom to invest in capital projects without the limitation of Section 94 controls, provided their programmes can be shown to be affordable, prudent and sustainable.

3.2. This report builds on this framework outlining the Council's prudential indicators for 2007/2008 - 2009/2010. The key mandatory indicators required by the Code are illustrated for 2007/08 through to 2009/10 and, with a view to more fully informing the decision making process; local indicators are also included.

4. Summary

4.1. The Prudential indicators included in the attached appendix cover the following areas

(i) Capital Expenditure, Capital Financing Requirement and the Prudential Margin
(ii) Ratio of Financing Cost to Net Revenue Streams
(iii) Authorised Limit, Operational Boundary and External Debt
(iv) Impact on Council Tax and Housing Rents
(v) Treasury Management Indicators

5. Conclusion

5.1. The indicators illustrated in the appendix provide members with assurance that the key objectives of the Prudential Framework (i.e. prudence and affordability) have been satisfied. When taken together, the indicators illustrate that the proposed capital investment plans for 2007/08 onwards are prudent and affordable. Healthy prudential margins from 2006/07 onwards justify the investment levels, the cost or affordability of which is contained within the existing financial strategies, for both the Housing Revenue Account and General Services Account .

6. Recommendations

6.1 The Policy and Resources (Finance) Sub-Committee approve the Treasury Management Strategy 2007/2008 outlined within the appendix to this report.

6.2 The Policy and Resources (Finance) Sub-Committee adopt the Prudential Indicators and limits for 2007/2008 to 2009/2010 illustrated within the appendix to this report.

Director of Finance

Members wishing further information should contact Mrs. K Hassell, Treasury Manager, Tel No 01698 302235

Treasury Management Strategy 2007/08 and Prudential Indicators 2007/08 to 2009/10

Appendix A

1. Introduction

1.1 Treasury Management deals with the borrowing and investment activity of the Council, and is an integral part of the financial management of the Council's affairs. It seeks to ensure that both capital borrowing requirements and day to day revenue cash transactions are fully funded. Its importance has increased as a result of the additional freedoms provided by the Prudential Code, and there are specific treasury prudential indicators included in this strategy that require approval.

1.2 The prudential indicators outlined within section 8 of this appendix consider the affordability and impact of capital expenditure decisions, whilst the treasury service considers the effective funding of these decisions. Together these form part of a process to ensure the Council meets its balanced budget requirement specified in the Local Government Finance Act 1992.

1.3 The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management, 2002). This Council adopted the Code of Practice on Treasury Management on 5th November 2002, and correspondingly adopted the Treasury Management Policy Statement. Adopting the CIPFA Code of Practice meets the requirements of the first of the treasury prudential indicators.

1.4 The Code of Practice requires the Council to produce reports on its Treasury Management policies, practices and activities on a regular and ongoing basis. This encompasses the preparation and approval of an Annual Strategic Plan, which defines the arrangements for managing the Treasury function in the incoming year. This report details the proposed strategy for 2007/08.

1.5 This strategy covers:

- The Council's debt and investment projections;
- The expected movement in interest rates;
- The Council's borrowing and investment strategies;
- Treasury performance indicators;
- Specific limits on treasury activities.

2. Background

2.1 The Council's long-term loans portfolio amounts to £474.2 million, the majority of which has been accumulated to source capital investment programmes inherited at local government reorganisation. Conversely, the Council has external short- term cash investments of approximately £40m (inc. Bank overdraft), which has been generated by surplus cash inflows.

3. Borrowing Requirement 2007/2008

3.1 Information available as at 31st December 2006 indicates that Members will be asked to approve a Capital Programme of £103 million for 2007/08, which includes a long-term borrowing requirement of £44.5m.

3.2 Taking into account the scheduled debt amortisation of £26m and existing short-term investment levels of approximately £40m, it is anticipated that the 2007/2008 borrowing requirement will primarily be funded using ongoing investment balances rather than seeking new funds from sources such as the PWLB.

3.3 Table 1 below illustrates the anticipated borrowing and investment levels over the next three years.

	2006/07 Revised £m	2007/08 Estimated £m	2008/09 Estimated £m	2009/10 Estimated £m
External Debt				
Debt at 1 April	476.5	474.2	471.9	477.0
Maturing Debt Repaid	-2.3	-2.3	-1.8	-7.0
Maturing Debt Replacement	0	0	1.8	7.0
Proposed New Borrowing to meet CFR	0	0	5.2	9.0
Debt at 31 March	474.2	471.9	477.0	486.0
Annual change in debt	2.3	2.3	5.1	9.0
Investments				
Total Investments at 31 March	40.0	20.8	15.5	16.2
Investment change	-4.0	-19.2	-5.3	+0.7
Capital Financing Requirement	3.0	18.0	12.0	9.0
Investments utilised to meet CFR	3.0	18.0	6.8	0

Table 1 – Debt and Investment Projections, 2007/08 – 2009/10

3.4 From the above table based on current projections it is anticipated that in 2008/2009 and 2009/2010 additional borrowing will be undertaken to assist in meeting the Capital Financing requirements in these years and the replacement of maturing debt. This will ensure that investment balances will be retained at a prudent level to meet cashflow demands on a daily basis and also surplus balances retained ,that have accumulated as a result of monies held in reserve.

4. Outlook for Interest Rates

4.1 Buoyant economic activity in 2006 and the strength of external cost pressures prompted a tightening of monetary policy as the Monetary Policy Committee (MPC) sought to prevent inflation from rising above the upper levels of the Government's target range.

4.2 Official concerns have abated but the continued risks of increasing pay settlements, rising unit costs, and buoyant consumer spending, and the impact that these may have on inflation pressures suggest that the Bank of England will maintain a cautious approach to rates throughout much of 2007.

4.3 Economic forecasters predicted the current base rate of 5% would increase by ¼% to 5¼% in March 2007. However, the MPC announced a base rate increase of ¼% on 11th January 2007. It is anticipated that rates will return to the 5% level in the closing stages of 2007/08 as economic activity and inflation pressures reduce, resulting in little movement in rates during the financial year

5. Borrowing Strategy 2007/08 – 2009/10

5.1 Based on a review of information available in the Annual Accounts 2005/06, available economic and interest rate forecasts, and previous borrowing decisions, the Council will take a cautious approach to borrowing over the next three years.

5.2 Rate forecasts combined with the availability of internally accumulated cash funds indicate that the need to undertake additional borrowing in 2007/2008 is not urgent.

5.3 However as mentioned earlier and shown in Table 1 above, based on current projections it is anticipated that in 2008/2009 and 2009/2010 additional borrowing will be undertaken to assist in meeting the Capital Financing requirements in these years and the replacement of maturing debt.

5.4 As the Council has a three year capital expenditure plan and investment/borrowing analysis this enables the Council to take advantage of opportunities that may arise to achieve beneficial borrowing rates over the same period.

5.5 Scope exists for the Council to wait for potential opportunities of locking in lower long-term rates at any time during the three year period, which may include borrowing in 2007/2008 in advance of future years' requirements. Any new borrowing will take account of the debt maturity profile to ensure that an acceptable amount matures in any one year and is also undertaken at the most advantageous rate in the yield curve.

5.6 With the likelihood of increasing interest rates and uncertainty regarding future accounting treatment, debt restructuring is likely to take place later in the financial year or, may even be delayed into future years. However, the Finance Department will monitor prevailing rates with a view to identifying beneficial rescheduling opportunities during the year.

5.7 The Council's borrowing requirement will primarily be met from internally accumulated cash funds, where these are available. Where additional sums are deemed to be required, the Public Works Loan Board (PWLB) will be the next major source of funding.

5.8 On occasions, leasing will be used if an option appraisal review identifies this as being advantageous to the Council.

5.9 No more than 25% or £15m, whichever is the greater, shall be taken from any one lender at any one time, except for borrowing from Public Works Loan Board, unless expressly approved by the Director of Finance.

6. *Investment Framework and Lending Strategy*

6.1 Although the yield or return on investment is a key consideration, the primary principle governing the Council's investment criteria is the security of its investments.

6.2 At its meeting of 24th January 2006, the Policy & Resources (Finance) sub-committee endorsed the introduction of a criteria-based counterparty list. In addition to detailing the financial institutions that the Council may invest in, this list maximises security and liquidity of investment through specifying maximum time limits and values for each type of institution.

6.3 The time limits detailed in the Council's couterparty list regarding short-term investments with institutions are as follows:

	Fitch	Moody's	Standard & Poors	Money Limit	Time Limit
Upper Limit Category *E.g. Halifax plc*	F1+	P-1	A-1	£15m	364 days
Middle Limit Category *E.g.: Bradford & Bingley*	F1	P-2	A-2	£10m	364 days
Lower Limit Category *E.g.: Adam & Co*	-	-	-	£5m	6 months
Other Institution Limits *E.g.: other authorities*	-	-	-	£10m	364 days

Table 2 – Summary of Council's Investment Criteria

6.4 Fitch, Moody's and Standard & Poors are generally accepted as being the world's foremost providers of independent credit ratings, hence the ratings provided by these bodies define the likelihood of an investor such as the Council receiving their money back on the terms in which it was invested. By way of an illustration, an institution such as Halifax plc with a short-term Standard & Poors rating of A-1 is deemed to have an ***extremely strong capacity to meet its financial commitments,*** hence there is very little risk to the Council in investing its surplus funds with an institution such as this. (***Explanations of credit rating definitions are provided in Appendix B***)

6.5 Investment decisions are based on shorter-term interest rates, which are expected to peak at 5¼% in early 2007. With a view to obtaining value and security, the Finance department will undertake the most appropriate form of investments available. Although this is dependent on interest rates prevailing at the time, it is hoped that there will be opportunities to invest surplus funds at fixed rates for longer periods of time.

7. Performance Indicators

7.1 The Code of Practice on Treasury Management requires the Council to use performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, which are additional to the predominantly forward-looking prudential indicators outlined in later sections of this report.

7.2 This Council generally uses the following historic indicators to monitor its loan portfolio:

- Borrowing - Average rate of borrowing for the year compared to average in previous year, and average available overall;
- Investments – Internal returns above the 7 day LIBID rate

The results of these indicators are reported each year in the Annual Treasury Activity Report.

8. Prudential Indicators 2007/08 to 2009/10

8.1 Treasury Management Prudential Indicators

8.1.1 *Interest Rate Exposures*

8.1.1.1 The Prudential Code requires the Council to set limits regarding its maximum exposure to both fixed and variable interest rates, and to then contain the activity of its Treasury function within these self-determined upper limits.

8.1.1.2 The Council's current loan portfolio consists of both fixed and variable rate debt, plus a variety of variable rate investments. The Code requires authorities to set limits that manage risk and reduce the impact of an adverse movement in interest rates, primarily on variable rate loans. Table 3 highlights the limits for approval.

Interest Rate Exposures: -	2007/08	2008/09	2009/10
Limits on fixed interest rates based on net debt	110%	110%	110%
Limits on variable interest rates based on net debt	25%	25%	25%

Table 3– Interest Rate Exposure Upper Limits

8.1.1.3 In addition to the mandatory indicator regarding fixed and variable interest rate exposure, members are also asked to consider and approve some local indicators, that better illustrate the Council's anticipated treasury management strategy.

8.1.1.4 Based on information available as at 31st December 2006, it is anticipated that the Council's loan portfolio for 2007/08 to 2009/10 will be exposed to interest rate changes as follows:

Content of loan portfolio	**2007/08**		**2008/09**		**2009/10**	
	Value	**%**	**Value**	**%**	**Value**	**%**
	£000s		£000s		£000s	
Interest Council is due to pay:						
Loans with Fixed rate debt	31,309	97.73	31,337	97.89	31,735	98.24
Loans with Variable rate debt	726	2.27	674	2.11	570	1.76
	32,035	100.0	32,011	100.0	32,305	100.0
Interest Council is due to receive:						
Variable rate investments	2,307	100.0	1,894	100.0	1,634	100.0
Net Loan Interest Payments	**29,728**		**30,117**		**30,671**	

Table 4 – Local Indicators regarding Interest Rate Exposures

8.1.1.5 Table 4 highlights for example that the Council anticipates net loan interest payments of approximately £29.728 million for 2007/08. Of this total, £31,309 million relates to loans that are fixed rate debt, and for which interest payments are guaranteed until the loans mature. Conversely, £0.726 million relates to loans which are variable rate, and £2.307 million relates to investments which the Council anticipates receiving interest from. Variable rate loans and investment interest are subject to changes in interest rates, and will be monitored as part of the Council's Treasury Management Strategy on an ongoing basis.

8.1.2 ***Maturity Structure of Borrowing***

8.1.2.1 The Prudential Code requires the Council to specify upper and lower limits regarding the maturity structure of its fixed rate borrowing in order to minimise the risk associated with the Council having to replace large sums of fixed rate debt at a time when there may be uncertainty over interest rate exposure.

8.1.2.2 Table 4 illustrated that the Council has high levels of fixed rate debt, however the current maturity profile of this debt is unlikely to be a major risk factor for the Council. Table 5 below illustrates the limits of fixed rate maturity which members are requested to approve as per the prudential code.

8.1.2.3 These limits allow for any fixed debt falling due for repayment as part of a debt restructuring exercise. For comparison and decision-making purposes, local indicators relating to the maturity profiles regarding fixed rate debt as anticipated at 1st April 2007, 2008 and 2009 are also illustrated.

Maturity Structure of borrowing	**< 12 months**	**12 months to 2 years**	**2 to 5 years**	**5 to 10 years**	**10 years + above**
Upper limit maturing on fixed rate debt	**5%**	**5%**	**10%**	**25%**	**90%**
Maturity profile; fixed debt 1/4/07	0.30%	0.19%	6.18%	15.90%	77.43%
Maturity profile; fixed debt 1/4/08	0.19%	1.37%	6.85%	16.84%	74.75%
Maturity profile; fixed debt 1/4/09	1.33%	2.36%	6.80%	16.47%	73.04%

Table 5– Maturity Structure of Fixed Rate Borrowing

8.1.3 ***Total principal funds invested for more than 364 days***

8.1.3.1 The Prudential Framework created enhanced investment opportunities for local authorities, so in order to ensure that councils contain their exposure to potential losses arising from having to repay long-term investments early, the Code requires authorities to set upper limits on funds being invested for more than 364 days.

8.1.3.2 This Council currently has no plans to radically alter its investment strategy and has no proposals to invest funds for periods of more than 364 days, in any of the forthcoming years.

8.2 **The Capital Expenditure Plans**

8.2.1 A certain level of expenditure will be grant supported by the Government; anything above this level will be unsupported and will require to be paid for from the Councils own resources. The Government retains an option to control either the total of all council's plans, or those of a specific council, although no control has yet been required.

8.2.2 The key risks to the plan are that the level of government support has been estimated and is therefore subject to change. Similarly some of the estimates for other sources of funding, such as capital receipts, may also be subject to change over this timescale.

8.2.3 Table 6 sets out the proposed Capital expenditure plans subject to approval by the Council for 2006/2007 (revised) and the period 2007/2008 to 2009/2010 for both the General Services and HRA Capital programmes.

Capital Expenditure	**2006/07 Revised £m**	**2007/08 Estimated £m**	**2008/09 Estimated £m**	**2009/10 Estimated £m**
Total Spend				
Non-HRA	76	61	49	49
HRA	42	42	43	41
Financed by:				
Capital Receipts	56	35	34	33
Capital Grants	21	13	8	8
CFCR	14	11	10	9
Borrowing	27	44	40	40

Table 6 – Capital Expenditure Plans 2007/08 to 2009/10

8.3 The Councils Borrowing need (the Capital Financing Requirement)

8.3.1 The CFR is simply the total outstanding expenditure that has not yet been paid for from either revenue or capital resources. It is essentially a measure of Council's underlying borrowing need i.e. capital expenditure which is not resourced by capital grants, receipts or CFCR and any new borrowing will increase the CFR.

8.3.2 However the Council pays off an element of the accumulated capital spend each year through a revenue charge (the scheduled debt amortisation) which reduces the CFR.

8.3.3 The Council is asked to approve the CFR projections below.

	2006/07 Revised £m	2007/08 Estimated £m	2008/09 Estimated £m	2009/10 Estimated £m
Capital Financing Requirement				
Non-HRA	343	356	366	372
HRA	104	109	111	114
Total CFR	447	465	477	486
Movement in CFR	**+3**	**+18**	**+12**	**+9**

Table 7 – CFR Projections 2007/08 to 2009/10

8.3.4 The movement in CFR is represented by

	2006/07 Revised £m	2007/08 Estimated £m	2008/09 Estimated £m	2009/10 Estimated £m
Borrowing	+27	+45	41	40
Scheduled Debt Amortisation	-23	-26	-28	-30
Other financing movements	-1	-1	-1	-1
Movement in CFR	**+3**	**+18**	**+12**	**+9**

Table 8 – Movements in CFR

8.4 Limits to Borrowing Activity

8.4.1 Within the prudential indicators there are a number of key indicators to ensure the Council operates its activities within well-defined limits.

8.4.2 For the first of these the Council needs to ensure that its total borrowing net of any investments, does not, except in the short-term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2007/08 and the next two financial years.

	2006/07 Revised £m	2007/08 Estimated £m	2008/09 Estimated £m	2009/10 Estimated £m
Gross Borrowing	484	482	487	496
Investments	-50	-31	-26	-26
Net Borrowing	434	451	461	470
Capital Financing Requirement	447	465	477	486
Prudential Margin	**13**	**14**	**16**	**16**

Table 9 – Prudential Margins 2007/08 to 2009/10

8.4.3 The above table demonstrates that healthy prudential margins will continue to exist from 2006/2007 onwards and that the Council complies with this prudential indicator in the current year and does not envisage difficulties in the future. This view takes into account current commitments, existing plans and the proposals in respect of the capital investment levels proposed.

8.4.4 ***The Authorised Limit for External Debt.***

8.4.4.1 This represents the maximum limit beyond which borrowing is prohibited. Although this limit is deemed to be affordable in the short-term, it is not desirable or a sustainable level of borrowing for the council and is therefore being set at a level as the maximum allowable in each of the years 2007/2008 through to 2009/2010.The level set for 2006/2007 is shown for comparison. This is the statutory limit determined under the Local Government (Scotland) Act 2003

Authorised Limit	2006/07 Revised £m	2007/08 Estimated £m	2008/09 Estimated £m	2009/10 Estimated £m
Borrowing	519	529	529	529
Other Long-Term Liabilities	1	1	1	1
Total	520	530	530	530

Table 10 – Authorised Limits

8.4.5 ***The Operational Boundary for External Debt.***

8.4.5.1 This indicator is based on the expected maximum external debt during the course of the year; it is not a limit. This operational boundary allows flexibility to borrow, re-invest and undertake debt restructuring during the course of the year. It is therefore possible and acceptable, for actual borrowing to vary around this boundary for short periods during the year.

Operational Boundary	2006/07 Revised £m	2007/08 Estimated £m	2008/09 Estimated £m	2009/10 Estimated £m
Borrowing	484	489	499	499
Other Long-Term Liabilities	1	1	1	1
Total	485	490	500	500

Table 11 – Operational Boundary

8.5 Affordability Prudential Indicators

8.5.1 The previous sections cover the Treasury and overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the overall Council finances, namely the impact the increased programme has on council tax and housing rent levels. The Council is asked to approve the following affordability indicators.

8.5.2 ***The Ratio of Financing Costs to Net Revenue Stream.***

8.5.2.1 Since capital expenditure impacts on the revenue budget through financing charges, the Council needs to ensure that financing costs not only remain affordable, but also don't constitute an excessive proportion of the revenue resources available. To assist with this matter, ratios of borrowing costs to revenue forecasts for the next 3 years are illustrated in table below. The table demonstrates that, non-HRA loan charges are estimated to represent between 5.64% and 6.41% of the total revenue budget available. Although the estimates gradually increase from 2006/07 onwards, the increase is not substantial; hence additional capital investment appears to be affordable and sustainable.

8.5.2.2 In noting the percentage on loan charges within the HRA budget, a major element of revenue costs in the Housing Account is the funding support to sustain the substantial investment programme; the other main elements of expenditure being repair costs and management costs. The level of loan charges is acceptable and deemed prudent and affordable within the framework of the Council's 30-year Housing investment plan.

	2006/07 Revised %	2007/08 Estimated %	2008/09 Estimated %	2009/10 Estimated %
Non HRA	5.64	5.84	6.20	6.41
HRA	18.54	18.76	19.48	20.14

Table 12 – Ratio of Financing Costs to Net Revenue Streams

8.5.3 ***Estimates of Impact on Council Tax Levels***

8.5.3.1 This indicator identifies the revenue cost impact associated with **new schemes** introduced to the three year capital programme per capital investment proposals above, when compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of government support.

	Proposed Budget 2007/2008	Forward Projection 2008/2009	Forward Projection 2009/2010
Council Tax Band D	£12	£12	£12

Table 13 – Estimate of Impact on Band D Council Tax