Committee:	**Audit, Best Value and Community Services Scrutiny**
Date:	**9 November 2011**
By:	**Director of Corporate Resources**
Title of report:	**Treasury Management Update**
Purpose of report:	**To present an update on Treasury Management**

RECOMMENDATION:

The Audit and Best Value and Community Services Scrutiny Committee is asked to receive an update on Treasury Management and to note our Treasury Management performance for the first six months and the changes to our Strategy for 2011/12.

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1. Background Information

1.1 At the meeting on 1 September 2011, the Committee received a presentation on Treasury Management.

1.2 As a result of recent changes to market conditions, the Treasury Management Strategy has been updated for the current year and has been included with the half yearly update which is sent to Cabinet in November each year.

1.3 A copy of the report which will be sent to Cabinet on 15 November 2011 is attached for information.

SEAN NOLAN

Director of Corporate Resources

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Local Member: All

<u>Background Documents</u>

None

APPENDIX

Report to:	**Cabinet**
Date:	**15 November 2011**
By:	**Director of Corporate Resources**
Title of report:	**Treasury Management – Half year review and amendment to our Strategy for 2011/12.**
Purpose of report:	**To present a mid year review of the County Council's performance on treasury management for the half year to 30th September 2011 and to change our Strategy because of changes to market conditions.**

RECOMMENDATION: The Cabinet is recommended to note to the County Council the treasury management performance for the half year to 30th September 2011 and to recommend to the County Council to amend the Treasury Management Strategy for 2011/12.

1. Financial Appraisal

The Code of Practice for Treasury Management requires the review of the Council's treasury management performance to be reported half way through the year as well as at the end of each year. A report is also required to change our Strategy during the year.

2. Supporting Information

2.1 Introduction

The County Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance. The County Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector and operates its treasury management service in compliance with this Code. These require that the prime objective of the treasury management activity is the effective management of risk, and that its borrowing activities are undertaken in a prudent, affordable and sustainable basis and its treasury management practices demonstrate a low risk approach. The Code requires the regular reporting of treasury management activities to:

- Forecast the likely activity for the forthcoming year (in the Annual Treasury Strategy Report);
- Review actual activity for the proceeding year (in the Annual Stewardship Report); and
- A mid year review (this report).
- Changes to our Strategy (this report).

This report sets out:

- A summary of the original strategy agreed for 2011/12 and the economic factors affecting this strategy in the first six months of this year (Appendix A)
- Amendments to the Treasury Management Strategy for 2011/12. (Appendix A)
- The treasury management activity during the first six months (Appendix B);
- The performance to date of the Prudential Indicators, which relate to the Treasury function and compliance within limits (Appendix C).

2.2 The economic conditions compared to our original strategy for 2011/12

The original strategy and the economic conditions prevailing in 2011/12 are set out in Appendix A which is attached to this report. 2011/12 has continued the uncertain environment of the previous three years, with concerns over the economies of other European countries and their impact on the UK. The main implications have been ongoing counterparty risk and low investment returns.

2.3 The treasury activity during the first six months on short term investments and borrowing;

The Treasury Management Strategy

The strategy for 2011/12, agreed in January 2011, continued the prudent approach and ensured that all investments were only to the highest quality rated banks and only up to a period of one year. A more prudent approach has been adopted because of the uncertainties in the market. Investments in some banks were reduced from a period of up to three months to being on call (overnight only). By the middle of September, all investments were able to be called without notice.

Short term lending

The total amount received in short term interest for the six months to 30th September 2011 was £1.31m at an average rate of 0.94%. This was above the average of base rates in the same period (0.5%) but fell short of the aim to secure investment income of at least base rate plus 0.5% on the Council's general cash balances. This against a backdrop of ensuring, so far as possible in the current financial climate, the security of principal and the minimisation of risk. This Council has continued to follow an extremely prudent approach with security and liquidity as the main criteria before yield.

Long term borrowing

Details of our long term borrowing are included in Appendix B of the report. The important points are:

- No new borrowing was undertaken through PWLB during 2011/12 to date and is unlikely in the rest of the year. It was agreed to continue to use "internal borrowing" to finance new capital investment
- Although a proactive approach has been taken to repayment and restructuring of debt, no cost effective opportunities have arisen in the first six months of this year.

Short term borrowing

No borrowing was undertaken on a short-term basis so far in 2011/12 to cover temporary overdraft situations.

2.4 **Prudential Indicators which relate to the Treasury function and compliance with limits**

The County Council is required by the Prudential Code to report the actual prudential indicators after the end of each year. There are eight indicators which relate to treasury management and they are set out in Appendix C. The actual position for the County Council for 2011/12 so far this year is that performance against all borrowing and prudential indicators is within the limits set in the Strategy for the year.

2.5 **Changes to the Treasury Management Strategy for 2011/12**

The original Strategy, the reasons for changes, amendments, summary of changes and new Strategy are set out in Appendix A. The reasons for the amendments to the Strategy are in paragraphs 5.2 to 5.5, paragraphs 5.6 to 5.8 details the amendments and 5.9 summaries the changes.

3. Conclusion and reason for recommendation

This report updates the Cabinet and fulfils the requirement to submit a half yearly report in the form prescribed in the Treasury Management Code of Practice. Short term lending has achieved returns better than base rate. However, the rate is below the aim to secure investment income of at least base rate plus 0.5% on the Council's general cash balances. This reflects the aim to ensure so far as possible in the financial climate, the security of principal and the minimisation of risk. This Council has continued to follow an extremely prudent approach with security and liquidity as the main criteria before yield. Exposure to future risk continues to be minimised through proactive and constant review of the treasury management policy. The Treasury Management Strategy has been altered to reflect changes in market conditions and the importance of the Government's part ownership of certain Banks. The current emphasis must now be to be able to react quickly if market conditions worsen.

SEAN NOLAN
Director of Corporate Resources

Contact Officers: *Amanda Walker* Tel No. 01273 481820
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BACKGROUND DOCUMENTS
Cabinet 25 January 2011 Treasury Management Strategy for 2011/12
5 July 2011 Treasury Management Stewardship Report 2010/11
Audit and Best Value Scrutiny Committee 1 September 2011 Stewardship Report 2010/11
CIPFA Prudential Code
CIPFA Treasury Management in the Public Services- Code of practice
Local Government Act 2003 Local Government Investments –Guidance from the former Office of the Deputy Prime Minister

Appendix A

A summary of the strategy agreed for 2011/12 and the economic factors affecting this strategy and amendments to the strategy

1. Background information

1.1 Cabinet receive an annual Treasury Management Strategy report, normally in January or February, which sets out the proposed strategy for the year ahead. This strategy includes the limits and criteria for organisations to be used for the investment of cash surpluses and has to be approved by the County Council.

1.2 This Council has always adopted a prudent approach on its investment strategy and in the last few years, there have been regular changes to the list of the approved organisations used for investment of short term surpluses. This list is regularly reviewed to ensure that the Council is able to invest in the best available rates consistent with low risk; the organisations are regularly monitored to ensure that their financial strength and low risk has been maintained.

1.3 When the original strategy for 2011/12 was drawn up earlier in the year, the money markets were still volatile with Banks reluctant to lend to each other. In this climate ensuring the security of investments continues to be difficult and extreme caution has to be taken on where surplus funds can be invested.

2. Strategy for 2011/12

Borrowing

2.1 In recent years, the County Council had a strategy to borrow to support the Capital Programme and lend out other cash (rather than using internal borrowing). Historically this meant that the interest rate earned on cash balances was higher than the interest rate paid on loans from the Public Works Loans Board (PWLB). In the current financial climate, this interest rate differential has been removed. No new PWLB borrowing has taken place since January 2008 and is unlikely in the current climate unless long term PWLB rates reach a very low level (where the long term benefit would exceed the short term costs). Under the restructuring in February 2010, £23m of new loans were agreed to be taken in February 2012 at a rate of 4.39% to repay £23m of PWLB loans at 4.7% (repaid in February 2010). The average rate of all debt at 31 March 2012 (£264.2m) is estimated to be 5.20% if no new loans are taken and no beneficial rescheduling of debt is available.

2.2 The PWLB increased all of its lending rates on 20th October 2010 (the day of the Government's Comprehensive Spending Review) by 1% on all rates. However, it did not increase the rate of interest used for repaying debt so that not only the cost of our future borrowing has increased but our opportunity to restructure our debt when market conditions allow has been significantly reduced.

Investment

2.3 When the strategy was agreed in January of this year, the advice given to us by our advisors, Sector, was that short term rates were expected to remain on hold for a considerable time. The recovery in the economy had commenced, however recent growth figures were unlikely to be sustained. The danger of a double-dip recession was fading but the crisis in the euro-zone, the prospects of tight economic policies at home and tenuous consumer confidence meant the threat had still not evaporated completely.

2.4 The Government's determination to cut the size of the public sector deficit considerably more quickly than its predecessor would be a drag upon activity in the medium term. The void left by significant cuts in public spending will have to be filled by a number of alternatives – corporate investment, rising exports and consumers' expenditure. In terms of sheer magnitude, the latter was the most important and a strong recovery in this area was by no means certain. Without a rebound in personal spending, any recovery in the economy was set to be weak and protracted.

2.5 The Bank of England admitted that inflation will remain above target until 2012. Inflation performance remained a key risk to the future course of interest rates. Nevertheless, the perceived need to counter the fiscal squeeze via accommodative monetary policy suggested that barring deterioration from the current situation, the Monetary Policy Committee (MPC) would be prepared to hold rates at very low levels until the latter stages of 2011.

2.6 The outlook for long-term interest rates was favourable in the near term but was set to deteriorate in the latter part of 2011. Yields would be suppressed by continued investor demand for safe haven instruments following the uncertainties and unfolding tensions within the entire Eurozone. In addition to this, the market had been underpinned by evidence of decelerating activity in major economies and the coalition government's apparent determination to deal with the parlous state of public sector finances.

2.7 However, it was advised that while the UK's fiscal burden would almost certainly ease, it would be a lengthy process and deficits over the next two to three financial years would still require a very heavy programme of gilt issuance. Eventually, the absence of the Bank of England as the largest buyer of gilts would shift the balance between supply and demand in the gilt-edged market. Other investors would almost certainly require some incentive to continue buying government paper. This incentive would take the form of higher yields.

3. Original Strategy agreed for 2011/12

3.1 The strategy ensured that in the current economic climate a prudent approach was maintained. This would be achieved through investing with selected banks and funds which meet the Council's rating criteria. The emphasis would continue on security (protection of the capital sum invested) and liquidity (keeping money readily available for expenditure when needed) rather than yield. The strategy continued with this prudent approach and no change was proposed to change the period of investment from up to a year. There was no change to the list of counterparties or the limit of the investment which remained at a maximum of £60m.

3.2 It was recognised that movements within the money markets can happen with no notice and the Director of Corporate Resources would have to amend this strategy in order to safeguard Council funds. As in the past any such actions would be reported to the next Cabinet meeting.

3.3 It is not expected that any new external borrowing would be undertaken in 2011/12 however the limits set out in the Authorised Limit for Borrowing would allow such borrowing. External borrowing would only take place if the rates available were so low that the long term benefits would significantly exceed the short term cost.

3.4 Opportunities for cost effective repayment of existing debt and restructuring opportunities were to be constantly monitored and would be taken if and when they emerge.

3.5 Our policy gave some flexibility to borrow up to £18m in advance of future need. However, given the current interest climate, no external borrowing and certainly none in advance, was planned.

3.6 The funds of the Fire Authority would continue to be invested in line with their own specific policy.

3.7 The County Council funds would be invested as follows:-

Up to a maximum of £60m deposited up to a period of up to one year with any of the following: -

Bank / Fund
Barclays Lloyds/HBOS Nat West/RBS Santander UK HSBC Nationwide Individual Treasury Type Money Market Funds (AAA rated) Individual Cash Type Money Market Funds (AAA rated)

Only banks which are eligible for the Government's Credit Guarantee Scheme AND meet the following minimum rating criteria for at least two of the designated agencies to be used.

Ratings Agency	**Long Term**	**Short Term**
Fitch	AA-	F1+
Moody	AA3	P-1
Standards and Poors	AA-	A-1+

The policy retained the ability to revert to some, or even extensive use of the Government's Debt Management Account Deposit Facility (DMADF) if market risk conditions tighten.

3.8 The strategy going forward would continue with the policy of ensuring minimum risk but would also need to deliver secure investment income of at least bank rate on the Council's cash balances. (The actual target was bank rate plus 0.5%).

3.9 Additional requirements under the Code of Practice required the Council to supplement credit rating information. Whilst the above criteria relied primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information had been and would continue to be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Sovereign ratings, Credit Default Swaps, equity prices, the Sector security and liquidity model and the CIPFA National treasury risk model as well as media updates etc.) would be assessed when comparing the relative security of differing investment counterparties.

3.10 All of the investments were to be classified as Specified Investments. These investments are sterling investments of not more than one-year maturity with institutions deemed to be high credit quality or with the UK Government (Debt Management Account Deposit Facility). These are considered low risk assets where the possibility of loss of principal or investment income is small. The County Council does not have any Non Specified Investments which are ones of more than one-year maturity or with institutions which have a lesser credit quality.

4. Economic factors affecting the Strategy in the first six months of 2011/12.

4.1 Global economy

The Euro zone sovereign debt crisis continued with Spain, and particularly Italy, being the focus of renewed market concerns that they may soon join with Greece, Ireland and Portugal in needing assistance. This uncertainty and the lack of a co-ordinated or credible Euro zone response, left commentators concerned over the potential impact of sovereign default and resulting effect on the Euro zone banking sector. The approval by various countries of the €440bn bail out fund in September has brought temporary relief to financial markets but this does not provide a credible remedy to the scale of the Greek debt problem or the sheer magnitude of the potential needs of other countries for support.

This, coupled with political difficulties in the US over their plans to address the budget deficit, the size and control over the US sovereign debt, and the subsequent loss of the AAA credit rating from Standard and Poor's, has led to a much more difficult and uncertain outlook for the world economy.
Growth prospects in the US, UK and the euro zone have been lower than expected, with future prospects similarly cut. Whilst not a central view, concerns of a double dip recession in some Western countries have increased. World stock markets fell in the second quarter of 2011/12 as a consequence.

4.2 UK economy

Following zero growth in the final half of 2010/11 the UK economy grew by a weaker than expected 0.1% in the first quarter of 2011/12, providing a knock on effect to future growth prospects. Growth prospects will be governed by UK consumer sentiment, which is currently subdued due to falling disposable income. Higher VAT, overhanging debt, high inflation and concerns over employment are likely to weigh heavily on consumers into the future.

The announcement by the Monetary Policy Committee (MPC) on 6 October of a second round of quantitative easing of £75bn emphasised how seriously the MPC now views recession as being a much bigger concern than inflation. Although inflation remains stubbornly high, the MPC's expectation of future falls resulting in an under shoot of its 2% target opened the way for this new round of QE.

International investors continue to view UK government gilts as being a safe haven from the EU sovereign debt crisis. The consequent increase in demand for gilts has helped to add downward pressure on gilt yields and sent PWLB borrowing rates to low levels.

4.3 Outlook for the next six months of 2011/12

There remain huge uncertainties in economic forecasts due to the following major difficulties:

- the increase in risk that the UK, US and EU could fall into recession
- the likely political gridlock in the US preventing significant government fiscal action to boost growth ahead of the Presidential elections in November 2012
- the potential for a major EU sovereign debt crisis which could have a significant impact on financial markets and the global and UK economies
- the degree to which government austerity programmes will dampen economic growth;
- the potential for further quantitative easing, and the timing of this in both the UK and US
- the speed of recovery of banks' profitability and balance sheet imbalances and the risk of substantial losses being incurred on EU sovereign debt

The overall balance of risks is weighted to the downside:

- We expect low growth in the UK to continue, with a low Bank Rate to continue for at least 24 months, coupled with a possible further extension of quantitative easing. This will keep investment returns depressed.
- The expected longer run trend for PWLB borrowing rates is for them to rise, primarily due to the need for a high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries. However the current safe haven status of the UK may continue for some time, postponing any increases until 2012.

5. **Amendment and Revised Strategy for 2011/12**

5.1 Our Treasury Management Policy recognises that movements within the money markets can happen with no notice and the Director of Corporate Resources would have to amend this strategy in order to safeguard Council funds.

5.2 Although our Strategy allows for investments up to one year, the continuing uncertainties in the markets dictated that we continued with a mainly overnight (on call) policy with some small investments amount in percentage terms of three month investments. In the summer we switched to a complete on call policy and by mid September all of our investments can be returned within a working day.

5.3 On 7th October, the ratings agency Moody's reduced the credit ratings of twelve UK financial institutions including NatWest/RBS, Lloyds / HBOS and Santander UK. On 13th October, the ratings agency Fitch reduced the credit ratings of two UK financial institutions NatWest/RBS and Lloyds / HBOS. These rating agency reviews were part of a previously announced (May 2011) reassessment of the likely level of systemic (Government) support these institutions would get IF they were to get into financial difficulty in the future. The resultant downgrading should not necessarily be construed that these institutions are experiencing difficulty that would result in a default.

5.4 The consequence of the bank downgrades means we are operating outside our normal rating criteria with two banks i.e. ~ NatWest/RBS and Lloyds/HBOS ~ which fall below our minimum rating agency thresholds but within overall policy because the Director of Corporate Resources has discretion.

5.5 Our current position is that we have continued to invest in both Nat West/RBS and Lloyds/HBOS because

- The high level of Government Ownership of NatWest./RBS is (83%) and Lloyds HBOS (40.2%)
- UK Sovereign rating remains at AAA.
- We have an overnight policy and monies can be withdrawn without notice.
- Nat West/RBS is the County Council's banker.

5.6 The changes above will require the Strategy for 2011/12 (set out in Paragraph 3 of this Appendix) to be amended to continue with the prime objective of the effective management of risk and following our prudent policy.

5.7 Under paragraph 3.7, where the County Council funds will be invested are changed as follows:-

(A) UK Investment Without Government Equity Holding

Up to a maximum of £60m deposited up to a period of up to one year with any of the following: -

The current policy stance is overnight but the policy allows changes to reflect market conditions if and when they improve.

Bank / Fund / Local Authority
Barclays Santander UK HSBC Nationwide Individual Treasury Type Money Market Funds (AAA rated) which invest in Government Securities only Individual Cash Type Money Market Funds (AAA rated) Another Local Authority (Equivalent to the low risk of investing with the Government but not formally rated)

Only banks which meet the following minimum rating criteria for at least two of the designated agencies to be used.

Ratings Agency	Long Term	Short Term
Fitch	AA-	F1+
Moody	AA3	P-1
Standards and Poors	AA-	A-1+

(B) UK Investment With Government Equity Holding of minimum of 30%

We are taking 30% as a minimum level of significant associated company influence. In practice it serves as a trigger to formally review our position.

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Up to a maximum of £60m deposited up to a period of up to three months with the following: -

The current policy stance is overnight but the policy allows changes to reflect market conditions if and when they improve.

Bank
Lloyds/HBOS Nat West/RBS

Only banks which meet the following minimum rating criteria for at least two of the designated agencies are to be used. The banks will not be used if the UK Sovereign rating falls below AAA.

Ratings Agency	Long Term	Short Term
Fitch	A	F1
Moody	A2	P-1
Standards and Poors	A	A-1

The policy retains the ability to revert to some, or even extensive use of the Government's Debt Management Account Deposit Facility (DMADF) if market risk conditions tighten.

5.8 In addition to the Credit Ratings Agencies, various methods have and will be used to monitor the Banks and Funds and these are set out in paragraph 3.9. Other very safe alternative investments will be explored when they become available.

5.9 The changes in our policy can be summarised as follows:-

- The new policy splits the investments into two groups,
  (A) UK Investment Without Government Equity Holding and
  (B) UK Investment With Government Equity Holding of a minimum of 30%

UK Investment Without Government Equity Holding

- The reference to the Government's Credit Guarantee Scheme has been deleted as it is not now relevant.

- Investments can be made to other Local Authorities. (Equivalent to the low risk of investing with the Government but not formally rated)

- The policy would allow investments up to one year but would only be used if market conditions improve. The current policy is overnight only.

UK Investment With Government Equity Holding of a minimum of 30%

- Lloyds/HBOS and Nat West/RBS included within UK Investment With Government Equity Holding of over 30%

- The investment allowed up to three months but the current policy is overnight and allows changes to reflect market conditions if and when they improve.

- New lower ratings criteria but the banks will not be used if the UK Sovereign rating falls below AAA.

It was continued to be recognised that movements within the money markets can happen with no notice and the Director of Corporate Resources would have to amend this strategy in order to safeguard Council funds. As in the past any such actions would be reported to the next Cabinet meeting.

Appendix B

The treasury management activity during the first half year

1. Short term lending interest rates

1.1 Base interest rate has stayed at 0.5% in 2011/12 to date. The rate is the lowest ever rate and the rate has remained unchanged for the longest period on record. The last change was on 5th March 2009.

1.2 There have been continued uncertainties in the markets during the year to date as set out in Section 4 of Appendix A.

1.3 Additional market information including Sovereign ratings, Credit Default Swaps, equity prices, the Sector security and liquidity model and the CIPFA National treasury risk model as well as media updates etc have been used to assess the relative security of differing investment counterparties.

1.4 The strategy for 2011/12, agreed in January 2011, continued the prudent approach and ensured that all investments were only to the highest quality rated banks and only up to a period of one year. No changes to this Strategy have been required but a more prudent approach has been adopted because of the uncertainties in the market. Investments in some banks were reduced from a period of up to three months to being on call (overnight only). By the middle of September, all investments were able to be called with no notice.

1.5 The total amount received in short term interest for the six months to 30th September 2010 was £1.14m at an average rate of 0.92%. This was above the average of base rates in the same period (0.5%) but fell short of the aim to secure investment income of at least base rate plus 0.5% on the Council's general cash balances. This is against a backdrop ensuring, so far as possible in the financial climate, the security of principal and the minimisation of risk. This Council has continued to follow an extremely prudent approach with security and liquidity as the main criteria before yield.

2. Long term borrowing

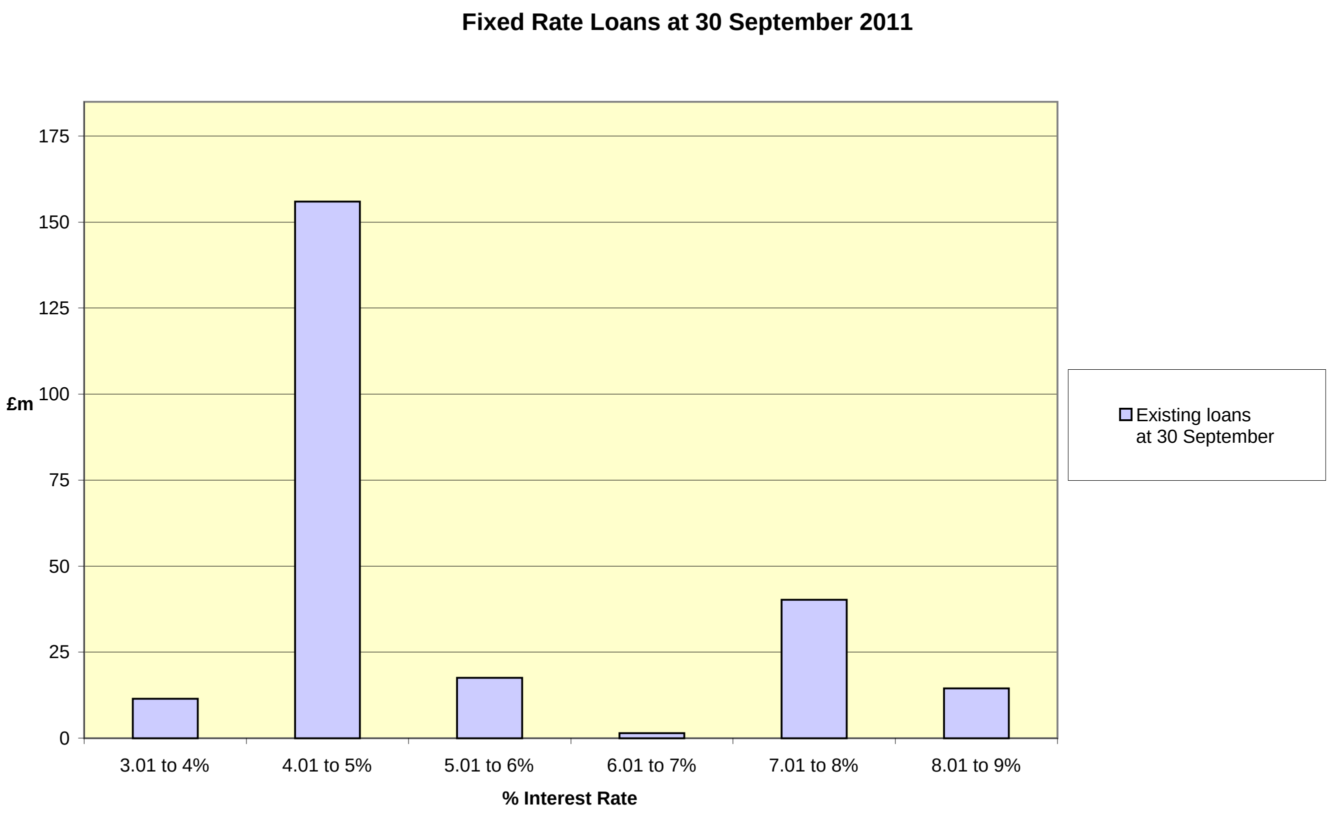
2.1 The County Council has had a strategy to borrow to support the Capital Programme and lend out other cash (rather than using internal borrowing). Historically this meant that the interest rate earned on cash balances was higher than the interest rate paid on loans from the Public Works Loans Board (PWLB). In the current financial climate, this interest rate differential has been removed. No new PWLB borrowing has taken place since January 2008 and is unlikely in the current climate unless long term PWLB rates reach a very low level (where the long term benefit would exceed the short term costs).

2.2 As well as using the existing cash balances to finance capital spending (rather than new borrowing), a restructure of our debt was undertaken in February 2010 where £23m of PWLB loans at a rate of 4.7% was repaid and will be replaced in February 2012 with market loans of £23m at rate of 4.39%. The repayments of PWLB loans and the replacement with market loans in two years time will result in a total savings of £1,149,153 over the first seven years after taking into account a premium payment made to the PWLB for compensation for an early repayment of loans. This was reported in the Stewardship report to Cabinet in June 2010.

2.3 The average interest rate of all debt at 31 March 2010 (£241.2m) is 5.31% and will be unchanged at 31 March 2011 as no new debt is planned in the current year. Under the restructuring in February 2010, £23m of new loans were agreed to be taken in February 2012 at a rate of 4.39% to repay £23m of PWLB loans at 4.7% (repaid in February 2010). The average rate of all debt at 31 March 2012 (£264.2m) is estimated to be 5.20% as long as no new loans are taken and no beneficial rescheduling of debt is available.

2.4 The PWLB increased all of its lending rates on 20th October (the day of the Government's Comprehensive Spending Review) by 1% on all rates. However, it did not increase the rate of interest used for repaying debt so that not only the cost of our future borrowing has increased but our opportunity to restructure our debt when market conditions allow has been significantly reduced.

The range of interest rates payable in all of the loans is illustrated in the graph below:



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3. Short term borrowing

3.1 No borrowing has been undertaken on a short-term basis during 2011/12 to date to cover temporary overdraft situations.

4 Treasury Management Advisers

4.1 The Strategy for 2011/12 explained that the County Council uses Sector as its treasury management consultant on a range of services which include:

- Technical support on treasury matters, capital finance issues and advice on reporting;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments;
- Credit ratings from the three main credit rating agencies and other market information;
- Assistance with training on treasury matters

Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice the final decision on treasury matters remained with the Council. This service remains subject to regular review.

4.2 Sector is the largest provider of Treasury Management advice services to local authorities in the UK and they claim to be the market-leading treasury management service provider to their clients.

4.3 The advice will continue to be monitored regularly to ensure an excellent level of advisory service provided to our authority.

Appendix C

Prudential Indicators which relate to the Treasury function and compliance with limits

1.1 The County Council is required by the Prudential Code to report the actual prudential indicators after the end of each year. There are eight indicators which relate to treasury management and they are set on an annual basis and monitored, they comprise:-:

- Operational boundary and authorised borrowing limits which includes short term borrowing (paragraph 1.2 below)
- Interest rate exposures (paragraph 1.3 below)
- Interest rate on long term borrowing (paragraph 1.4 below)
- Maturity structure of debt (paragraph 1.5 below)
- Maturity structure of investments (paragraph 1.6 below)
- Compliance with the Treasury Management Code of Practice (paragraph 1.7 below)
- Interest on investments (paragraph 1.8 below)
- Capital Financing Requirement and Minimum Revenue Provision (paragraph 1.9 below)

None of the limits has been exceeded in 2011/12 to date and are not likely to be exceeded.

1.2 **Operational and authorised borrowing limits.**

The tables below sets out the estimate and projected capital financing requirement and long-term borrowing in 2011/12

	CAPITAL FINANCING REQUIREMENT	**2011/12**	**2011/12**
		Estimate **£m**	**Likely Actual £m**
	Capital financing requirement at 1 April 2011	348*	340*
ADD	Borrowing to support capital programme	25	25
LESS	Provision for repayments of debt	-12	-13
		-------	-------
	Capital financing requirement at 31 March 2012	**361***	**352***
ADD	Net borrowing for next year	18	

	Operational boundary	**379**	
ADD	Short term borrowing	20	Nil

	Authorised limit	**399**	

* Includes £39m for PFI Schemes and Finance Leases.

	ACTUAL BORROWING	**2011/12**
		Likely Actual £m
	Long term borrowing at 1 April 2011	241.2
ADD	Borrowing in February 2012	23.0
	Long term borrowing at 31 March'12	**264.2**

The Operational boundary for borrowing was based on the same estimates as the authorised limit. It reflected directly the authorised borrowing limit estimate without the additional amount for short term borrowing included to allow, for example, for unusual cash movements. The Operational boundary represents a key management tool for in year monitoring and long term borrowing control.

The Authorised limit was consistent with the County Council's current commitments, existing plans and the proposals for capital expenditure and financing, and with its approved treasury management policy statement and practices. It was based on the estimate of most likely, prudent but not worst case scenario, with in addition sufficient headroom (short term borrowing) over and above this to allow for day to day operational management, for example unusual cash movements or late receipt of income. Risk analysis and risk management strategies were taken into account as were plans for capital expenditure, estimates of the capital financing requirement and estimates of cash flow requirements for all purposes.

The Authorised limit is the "Affordable Borrowing Limit" required by S3 of the Local Government Act 2003 and must not be breached. The estimated Long term borrowing at 31 March 2012 of £264.2m is under the Operational boundary and Authorised limit set for 2011/12. The Operational boundary and Authorised limit have not been exceeded during the year to date and will not be exceeded in the rest of the year.

1.3 **Interest rate exposures**

The County Council continued the practice of seeking to secure competitive fixed interest rate exposure for 2011/12. To provide flexibility however it set limits on our variable rate exposure in case that became a more effective approach. There are figures for both borrowing and lending and a combined borrowing and lending table.

Borrowing	2011/12 Estimate	2011/12 Actual
Fixed Rate Exposure		
Upper Limit	100%	100%
Lower Limit *	53%	
Variable Rate Exposure		
Upper Limit	47%	
Lower Limit *	0%	

(* assumes all new borrowing is variable)

Lending		
Fixed Rate Exposure		
Upper Limit	100%	100%
Lower Limit	0%	
Variable Rate Exposure		
Upper Limit	100%	
Lower Limit	0%	

Borrowing and Lending combined		
Fixed Rate Exposure		
Upper Limit	100%	100%
Lower Limit	26%	
Variable Rate Exposure		
Upper Limit	100%	
Lower Limit	0%	

In the first six months of 2011/12, all lending has been at fixed rates and the County Council has no variable rate loans at all and the flexibility in the interest rate exposure has not been required.

1.4 **Interest rate on long term borrowing**

The rate of interest taken on new long term borrowing will be monitored as the following targets have been set.

- Rate taken on borrowing is within 0.25% of lowest point for set loan period (i.e. 45-50 years) during the year

- Rate taken is within lowest eighth of rates available for set loan period (i.e. 45-50 years) during the year

No new borrowing has been taken in the current year to date.

1.5 Maturity structure of debt

The Council has set upper and lower limits for the maturity structure of its borrowings as follows.

	Lower limit	Upper limit
Under 12 months	0%	25%
12 months and within 24 months	0%	40%
24 months and within 5 years	0%	60%
5 years and within 10 years	0%	80%
10 years and within 20 years	0%	80%
20 years and within 30 years	0%	80%
30 years and within 40 years	0%	80%
40 years and above	0%	80%

The County Council has not exceeded the limits set in 2011/12.

	Actual at 30.9.2011
Under 12 months	0%
12 months and within 24 months	0%
24 months and within 5 years	4%
5 years and within 10 years	9%
10 years and within 20 years	18%
20 years and within 30 years	16%
30 years and within 40 years	20%
40 years and above	33%

In addition, two targets have monitored the maturity structure of our debt. Not more than £20m of debt should mature in any financial year and not more than 15% to mature in any two consecutive financial years. These targets are both in line at 30th September 2011.

New borrowing has been undertaken giving due consideration to the debt maturity profile, ensuring that an acceptable amount of debt is due to mature in any one financial year. This helps to minimise the authority's exposure to the risk of having to replace a large amount of debt in any one year or period when interest rates may be unfavourable. The bar chart in the attached Annex shows the maturity profile.

1.6 Maturity structure of investments

From 1 April 2004, the Investment Guidance issued by the Officer of Deputy Prime Minister, allowed local authorities the freedom to invest for more than for one year. All investments over one year were to be classified as Non-Specified Investments. The County Council had taken advantage of this freedom in previous years. No Non-Specified Investments are held within our overall portfolio of investments and in line with our prudent approach in our strategy, no new long term investments (over 364 days) will be been taken in 2011/12.

1.7 Compliance with the Treasury Management Code of Practice

East Sussex County Council has adopted the CIPFA *Code of Practice for Treasury Management in the Public Services.*

1.8 Interest on investments

The table below sets out the average monthly rate received on our investments and compares it to the Bank of England Base rate to reflect the interest rates available in the market, the reduced term of the investment to an overnight (on call) policy and limitation in the use of counterparties.

Month	Amount £000	Monthly rate	Margin over Base rate	Margin against Base plus 0.5%
April	206.1	0.95%	0.45%	-0.05%
May	218.4	0.95%	0.45%	-0.05%
June	212.9	0.95%	0.45%	-0.05%
July	225.2	0.93%	0.43%	-0.07%
August	226.1	0.91%	0.41%	-0.09%
September	220.1	0.91%	0.41%	-0.09%
First six months of 2011/12	**1,308.8**	**0.94%**	**0.44%**	**-0.06%**

The total amount received in short term interest for the six months to 30th September 2011 was £1.31m at an average rate of 0.94%. This was above the average of base rates in the same period (0.5%) but below the aim to secure investment income of at least base rate plus 0.5% on the Council's general cash balances whilst ensuring, so far as possible in the financial climate, the security of principal and the minimisation of risk. This Council has continued to follow an extremely prudent approach with security and liquidity as the main criteria before yield.

1.9 **Capital Financing Requirement and Minimum Revenue Provision (MRP)**

The Council's Borrowing Need (the Capital Financing Requirement)

The prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of Council's underlying borrowing need.

The Council was asked to approve the CFR projections below:

£m	**2011/12 Likely Actual**	**2012/13 Estimate**	**2013/14 Estimate**
Total CFR	**352**	**360**	**369**
Movement in CFR	**12**	**8**	**8**

Movement in CFR represented by			
Net financing need for the year (above)	25	21	21
MRP/VRP and other financing movements	-13	-13	-13
Movement in CFR	**12**	**8**	**8**

The Council is required to pay off an element of the accumulated General Fund capital spend each year through a revenue charge (the Minimum Revenue Provision – MRP). The Capital Financing Requirement and Minimum Revenue Provision will not be exceeded in 2011/12.

1.10 The Council has implemented MRP guidance and assess the MRP for 2011/12 in accordance with the main CLG Regulations contained within the guidance issued by the Secretary of State under section 21 (1A) of the Act. A variety of options are provided to councils, so long as there is a prudent provision. The major proportion of the MRP for 2011/12 will relate to the more historic debt liability for capital expenditure incurred before 1 April 2008 or which in the future will Supported Capital Expenditure, the MRP policy will be:

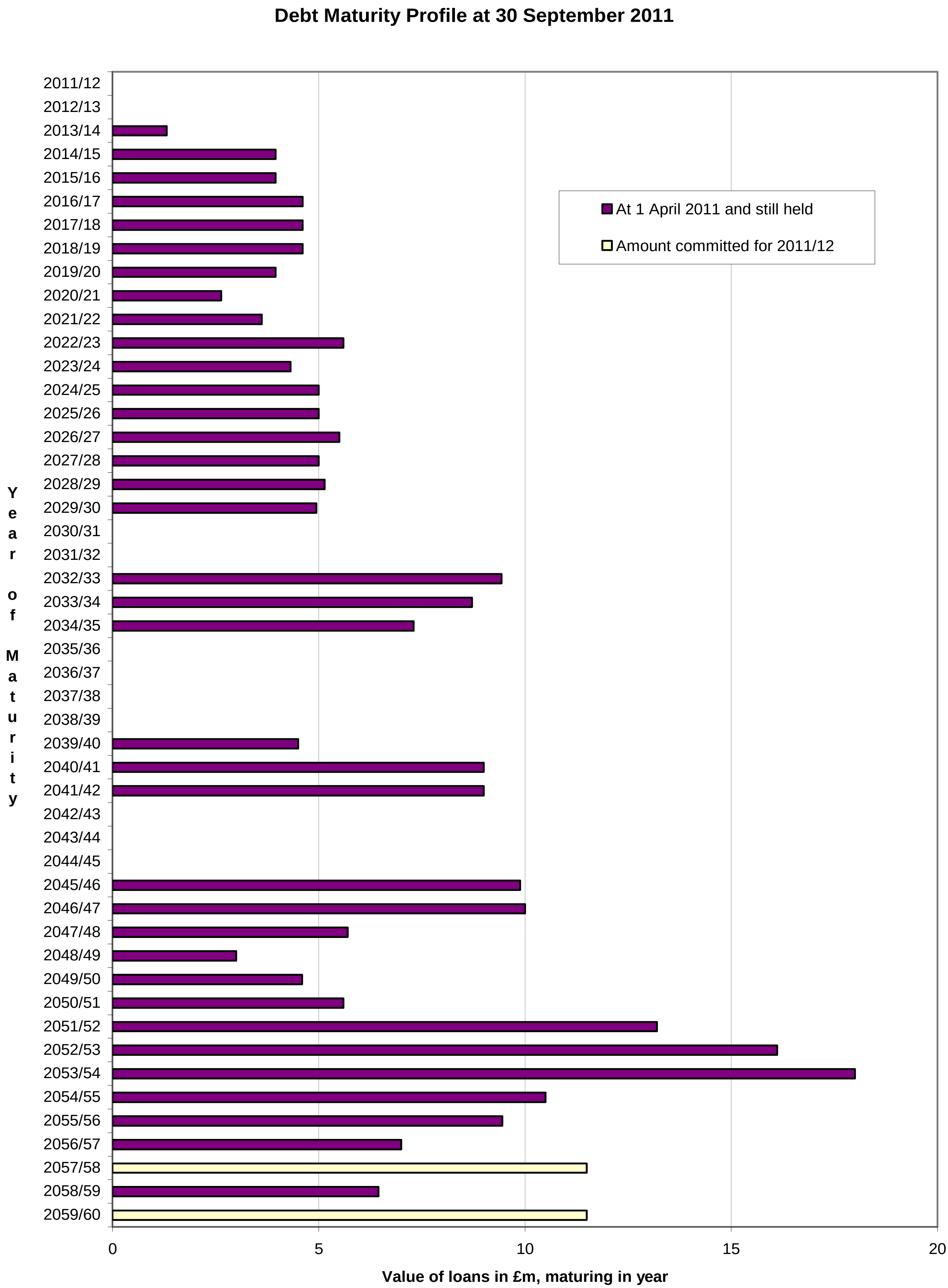
- Based on based on the non-housing CFR, i.e., The Council currently set aside a Minimum Repayment Provision based on basic MRP of 4% each year to pay for past capital expenditure and to reduce its CFR.

1.11 From 1 April 2008 for all unsupported borrowing the MRP policy will be:

- Asset Life Method – MRP are based on the estimated life of the assets, in accordance with the proposed regulations (this option will be applied for any expenditure capitalised under a Capitalisation Direction).

- Asset Life Method (annuity method) - The Council has also adopted the annuity method, - MRP calculated according to the flow of benefits from the asset, and where the principal repayments increase over the life of the asset. The policy is being adopted as a result of PFI's and Finance Leases assets now accounted for within the Council's balance sheet and any related MRP will be equal to the amount of principal repayment.

Annex


Debt Maturity Profile at 30 September 2011
At 1 April 2011 and still held
Amount committed for 2011/12
Year of Maturity
2011/12
2012/13
2013/14
2014/15
2015/16
2016/17
2017/18
2018/19
2019/20
2020/21
2021/22
2022/23
2023/24
2024/25
2025/26
2026/27
2027/28
2028/29
2029/30
2030/31
2031/32
2032/33
2033/34
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2045/46
2046/47
2047/48
2048/49
2049/50
2050/51
2051/52
2052/53
2053/54
2054/55
2055/56
2056/57
2057/58
2058/59
2059/60
0
5
10
15
20
Value of loans in £m, maturing in year