Shropshire Council

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TREASURY STRATEGY 2010/11

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Summary

The report explains the implications of the revised Treasury Management CIPFA Code of Practice 2009. It also proposes the Treasury Strategy for 2010/2011 and recommends Prudential Indicators for 2010/11 to 2012/13. The report is technical in nature but the key points to note are:-

- The Treasury Strategy includes prudential borrowing of £20.9 million for 2010/11 of which £11.98 million relates to previously reported prudential borrowing for Children & Young Peoples Services (CYPS) schemes. The capital programme report for 2010/11 to 2014/15 includes further prudential borrowing of £7.1 million for various schemes and £1.82 million for carbon efficiency schemes. The prudential borrowing costs for these schemes will be met from within existing resources and the savings generated from energy efficiency schemes. As a consequence, prudential borrowing will have no impact on Council Tax.

- 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 88% of their deposits. However, non priority creditors have objected to the criteria for priority creditors. Non priority creditors are currently expected to be repaid 36% of their deposits.

- The bank rate currently 0.50% is expected to reach 1.50% by the end of the financial year. Every 0.25% increase in the base rate equates to around £325,000 of additional interest receivable per annum on the Council's investments.

- Long term borrowing rates are expected to be higher than investment rates during 2010/11 therefore long term borrowing may be postponed in order to maximise savings in the short term. If borrowing is not undertaken in 2010/11 this would result in savings of around £480,000.

- The Council proposes 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 is proposed to offer to lend up to £10 million to each of these Housing Associations in order to support the building of affordable housing in Shropshire. Presently South Shropshire Housing and the Council are working together to draft a legal agreement that can make this work well for both parties. A full report will be brought to Cabinet and Full Council for approval.

Recommendations to Cabinet

Cabinet recommend that council:-

a) Adopt the revised Treasury Management CIPFA Code of Practice 2009, set out in Appendix 1.

b) Approve the Treasury Strategy for 2010/2011.

c) Approve the Prudential Indicators, set out in Appendix 2, in accordance with the Local Government Act 2003.

d) Approve the Investment Strategy, set out in Appendix 3 in accordance with the ODPM's (now DCLG) Guidance on Local Government Investments.

e) Approve the Minimum Revenue Provision (MRP) Policy Statement, set out in Appendix 4.

f) Authorise the Director of Resources 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.

g) Authorise the Director of Resources to use Foreign Banks which meet Sector's creditworthiness policy and Money Market Funds again if required when money markets stabilise.

h) Note the proposed Prudential Indicators would enable the Authority to use up to 5% of Council Tax in 2010/11 or future years, to fund borrowing under the Prudential Code should the Council decide to do so.

Recommendations to Strategic Overview and Scrutiny

i) Strategic Overview and Scrutiny are asked to note the report.

Recommendations to the Council

j) Adopt the revised Treasury Management CIPFA Code of Practice 2009, set out in Appendix 1.

k) Approve the Treasury Strategy for 2010/2011.

l) Approve the Prudential Indicators, set out in Appendix 2, in accordance with the Local Government Act 2003.

m) Approve the Investment Strategy, set out in Appendix 3 in accordance with the ODPM's (now DCLG) Guidance on Local Government Investments.

n) Approve the Minimum Revenue Provision (MRP) Policy Statement, set out in Appendix 4.

o) Authorise the Director of Resources 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.

p) Authorise the Director of Resources to use Foreign Banks which meet Sector's creditworthiness policy and Money Market Funds again if required as money markets continue to stabilise.

q) Note the proposed Prudential Indicators would enable the Authority to use up to 5% of Council Tax in 2010/11 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. In light of the Icelandic situation in 2008, CIPFA has amended the CIPFA Treasury Management in the Public Services Code of Practice (the Code), Guidance Notes and the template for the revised Treasury Management Policy Statement in 2009. It continues to be a requirement of the Code that this Council should formally adopt the Code. As the Code has been revised, the Council is asked to adopt the revised Code and the revised Treasury Management Policy Statement at Appendix 1.

3. The revised Code has emphasised a number of key areas including:-

- The Council must formally adopt the revised Code and four clauses.
- The strategy report will affirm that the effective management and control of risk are prime objectives of the Council's treasury management activities.
- The Council's appetite for risk must be clearly identified within the strategy report and will affirm that priority is given to security of capital and liquidity when investing funds and explain how this will be carried out.
- Responsibility for risk management and control lies within the organisation and cannot be delegated to an outside organisation.
- Credit ratings should only be used as a starting point when considering risk. Use should also be made of market data and information, the quality financial press, information on government support for banks and credit ratings of that government support.
- Council's need a sound diversification policy with high credit quality counterparties and should consider setting country, sector and group limits.
- Borrowing in advance of need is only permissible when there is a clear business case for doing so and only for the current capital programme or to finance future debt maturities.

- The main annual treasury management reports must be approved by full council.
- There needs to be, at a minimum, a mid year review of treasury management strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved.
- The Council must delegate the role of scrutiny of treasury management strategy and policies to a specific named body.
- Treasury management performance and policy should be subject to prior scrutiny.
- Members should be provided with access to relevant training.
- Those charged with governance are also personally responsible for ensuring they have the necessary skills and training.
- Responsibility for these activities must be clearly defined within the organisation.
- Officers involved in treasury management must be explicitly required to follow treasury management policies and procedures when making investment and borrowing decisions on behalf of the Council as stated in the Council's Treasury Management Practices.

4. This strategy statement has been prepared in accordance with the revised Code. 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 the Strategic Overview and Scrutiny Committee 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.

5. 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 Policy Statement (revised)	Full Council	Initial adoption 2010
Treasury Strategy/Annual Investment Strategy/MRP Policy	Full Council	Annually before the start of the financial year
Treasury Strategy/Annual Investment Strategy/MRP Policy – mid year report	Full Council	Mid year
Treasury Strategy/Annual Investment Strategy/MRP Policy – updates or revisions at other times	Full Council	As required
Annual Treasury Report	Full Council	Annually by 30 September after the end of the financial year

Area of Responsibility	Council/Committee/Officer	Frequency
Treasury Management Monitoring Reports	Reports prepared by Treasury Manager to the Head of Finance (Treasury & Pensions) who reports to the Director of Resources	Monthly
Treasury Management Practices	Director of Resources	Annually
Scrutiny of Treasury Strategy	Strategic Overview & Scrutiny	Annually before the start of the financial year
Scrutiny of the treasury management performance	Strategic Overview & Scrutiny	Quarterly

Revised CIPFA Prudential Code

6. CIPFA has also issued a revised Prudential Code which primarily covers borrowing and the Prudential Indicators. The following three indicators have now been moved from being Prudential Indicators to being Treasury Indicators:-

- Authorised limit for external debt.
- Operational boundary for external debt.
- Actual external debt.

7. However, all indicators will continue to be presented together in the Treasury Strategy. In addition, where there is a significant difference between the net and gross borrowing position, the risks and benefits associated with this strategy will be clearly stated in the annual strategy.

Revised Investment Guidance

8. It should be noted that the Department of Communities and Local Government (DCLG) is currently undertaking a consultation exercise on draft revised investment guidance which will result in the issue of amended investment guidance for English local authorities to come into effect from 1st April 2010. It is not currently expected that there will be any major changes required over and above the changes already required by the revised Code of Practice on Treasury Management. If there are any major changes then Members will be updated accordingly.

Treasury Strategy 2010/2011

9. 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.

10. 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.

11. 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.

12. The proposed Strategy for 2010/11 in respect of the following aspects of the treasury management function is based upon the Director of Resources' view on interest rates, supplemented with leading market forecasts provided by the Council's Treasury Advisor, Sector Treasury Services.

13. 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.

14. 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.

Treasury Limits for 2010/11 to 2012/13

15. 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.

16. 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'.

17. 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.

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

Prudential Indicators for 2010/2011 to 2012/2013

19. 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. Prudential Indicators for 2009/10 to 2012/13 are based on Shropshire Council, actual figures for 2008/09 relate to the former Shropshire County Council.

20. 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.

21. 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.

Prudential Indicator No. 1 & 2	2009/10 Estimate	2010/11 Estimate	2011/12 Estimate	2012/13 Estimate
	%	%	%	%
Non HRA ratio of financing costs (gross of investment income) to net revenue stream	9.9	11.6	12.8	14.2
Non HRA ratio of financing costs (net of investment income) to net revenue stream	9.6	11.1	12.4	13.7
HRA Ratio of financing costs to HRA net revenue stream	15.4	15.3	15.0	14.8

details of calculation are in Appendix 6 (Schedules 1&7)

22. The 2010/2011 to 2014/15 Capital Budget includes prudential borrowing of £20.9 million for 2010/11, £16.5 million for 2011/12 and £11.9 million for 2012/13.

23. The prudential borrowing in 2010/11 includes £11.98 million relating to previously reported Children and Young People's Services schemes of which £3.58 million will be met from the Dedicated School's Grant. The £5.4 million which was approved for the William Brookes School Pathfinder Project in July 2008 was subsequently reduced to £4.4 million in January 2010 following confirmation of an additional grant for the scheme. The remaining £4 million was approved in December 2008 for the Primary School Capital Programme. The debt charges associated with these projects will be met from within existing resources.

24. The capital programme 2010/11 to 2014/15 report includes additional prudential borrowing for this period. In addition to the £11.98 million for CYPS a further £7.1 million for main programme schemes and £1.8 million for energy efficiency schemes were included in 2010/11. For 2011/12 the programme includes £13.6 million for main programme schemes and a further £2.9 million for energy efficiency schemes. For 2012/13 a further £11.3 million for main programme schemes and £0.6 million for energy efficiency schemes are also included. The debt charges associated with these projects will be met from within existing resources and savings generated from the energy efficiency schemes.

25. 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 2010/11 to 2012/13 is zero.

Prudential Indicator No. 3	**2010/11**	**2011/12**	**2012/13**
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)	20.50	39.72	56.05
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	**20.50**	**39.72**	**56.05**

details of calculation are in Appendix 6 (Schedule 2)

26. 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 (OBC) and North Shropshire District Council (NSDC) 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^	**2008/09* Actual**	**2009/10 Estimate**	**2010/11 Estimate**	**2011/12 Estimate**	**2012/13 Estimate**
Net Borrowing & Capital Financing Requirement:	**£ m**	**£ m**	**£ m**	**£ m**	**£ m**
Gross Borrowing*	251	280	310	334	346
Investments*	60	149	150	150	150
Net Borrowing*	191	131	160	184	196
Non HRA Capital Financing Requirement^	253	279	310	335	354
HRA Capital Financing Requirement^	N/A	1.2	1.2	1.3	1.3

details of calculation and capital financing requirement are in Appendix 6 (Schedule 3)
**Shropshire County Council Only*

27. 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 2010/11, and the estimated expenditure for 2011/12 and 2012/13.

Prudential Indicator No. 6 & 7	2008/09* Actual	2009/10 Estimate	2010/11 Estimate	2011/12 Estimate	2012/13 Estimate
	£ m	£ m	£ m	£ m	£ m
Non HRA Capital expenditure	60	92	119	63	51
HRA Capital expenditure	N/A	2	5	8	3

*details of calculation are in Appendix 6 (Schedule 4) *Shropshire County Council only*

28. 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	2010/11	2011/12	2012/13
External Debt	**£ m**	**£ m**	**£ m**
Authorised Limit for External Debt:			
Borrowing	458	475	494
Other long term liabilities	46	47	49
Total	**504**	**522**	**543**

Details of calculation are in Appendix 6 (Schedule 5)

29. The Council is required to set an operational boundary for external debt. 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	2010/11	2011/12	2012/13
External Debt	**£ m**	**£ m**	**£ m**
Operational Boundary:			
Borrowing	401	419	439
Other long term liabilities	20	21	22
Total	**421**	**440**	**461**

Details of calculation are in Appendix 6 (Schedule 6)

30. The estimated external debt is based on the capital programme for 2009/10.

Prudential Indicator No. 12	31/03/09* Actual	31/03/10 Estimate
Actual External Debt	**£ m**	**£ m**
Borrowing	251	280
Other long term liabilities	0	0
Total	**251**	**280**

**Shropshire County Council Only*

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 will adopt the revised Code in February 2010.

31. 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 ^^	**2010/11**	**2011/12**	**2012/13**
Borrowing Limits			
	£ m	**£ m**	**£ m**
Upper Limit for Fixed Interest Rate Exposure *	401	419	439
Upper Limit for Variable Interest Rate Exposure ^	200	209	219
Lower Limit for Fixed Interest Rate Exposure **	201	210	220
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 (£401m in 2010/11) 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% (£200m in 2010/11) 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* Internal Indicator No. 3 ** No. 15 ^ Internal Indicator No. 4 ^^	**2010/11**	**2011/12**	**2012/13**
Investment Limits			
	£ m	**£ m**	**£ m**
Upper Limit for Fixed Interest Rate Exposure *	225	225	225
Upper Limit for Variable Interest Rate Exposure ^	225	225	225
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 £225m in 2010/11 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.

32. 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 2010/11*	**%**	**%**
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.**

33. 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	**2010/11**	**2011/12**	**2012/13**
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

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

Outstanding debt for capital purposes	**Actual £m**
Long-term fixed rate PWLB	231.2
Long term fixed rate – Market	49.2
Total	**280.4**

Investments	**£m**
Internally managed - long term (1 Year)	5.0
- short term cash flow	99.9
Total	**104.9**

Prospects for Interest Rates

35. 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 23 November 2009

	Mar 2010	**June 2010**	**Sept 2010**	**Dec 2010**	**Mar 2011**	**June 2011**	**Sept 2011**	**Dec 2011**	**Mar 2012**

Bank Rate	**0.50%**	**0.50%**	**0.75%**	**1.00%**	**1.50%**	**2.25%**	**2.75%**	**3.25%**	**3.50%**
5yr PWLB rate	**3.05%**	**3.20%**	**3.30%**	**3.40%**	**3.60%**	**3.85%**	**4.15%**	**4.55%**	**4.60%**
10yr PWLB rate	**4.00%**	**4.05%**	**4.15%**	**4.30%**	**4.45%**	**4.60%**	**4.80%**	**4.90%**	**5.00%**
25yr PWLB rate	**4.55%**	**4.65%**	**4.70%**	**4.80%**	**4.90%**	**5.00%**	**5.05%**	**5.10%**	**5.20%**
50yr PWLB rate	**4.60%**	**4.70%**	**4.75%**	**4.90%**	**5.00%**	**5.10%**	**5.15%**	**5.20%**	**5.30%**

The Council has budgeted for a cost of borrowing of 5% in 2010/11. Interest received on revenue balances is expected to be around 1% in 2010/11.

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

- rise from its current level of 0.50% to 0.75% in September 2010.
- reach 1.50% by the end of the financial year.
- rise to 3.50% by March 2012.

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

Short-term interest rates (investments)

36. Taking all the evidence together, it is felt that base rate will rise from its current level of 0.50% to 0.75% in September 2010 with a further 0.25% rise expected in December 2010. Bank rates are expected to end the financial year at 1.50% following a 0.50% rise in March 2010. 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)

37. The 50 year PWLB rate is expected to rise gradually from current levels of 4.60% to reach 5.00% by the end of the financial year. It is then anticipated to rise gradually to reach 5.30% by the end of March 2012. 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 4.55% to reach 4.90% by the end of the financial year. It is then anticipated to rise to 5.20% by the end of March 2012. The 10 year PWLB rate is expected to rise from current levels of 4.00% to reach 4.45% by the end of the financial year. Again further rises are expected in 2011/12. The 5 year PWLB rates are also expected to rise from 3.05% to 3.60% by the end of March 2011 and to 4.60% by the end of March 2012.

Capital Borrowing Strategy

38. The estimated borrowing requirement for 2010/2011 is calculated as follows:

	£m
Supported capital expenditure (revenue)	19.67
Prudential Borrowing	20.86
Repayment of loans maturing	2.51

Minimum Revenue Provision	(11.25)
Total Borrowing	**31.79**
Finance leases*	1.00
Total	**32.79**

* Note Finance leases have not been used since the introduction of the Prudential Code in 2004/2005. 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, there are a number of strategy options available:-

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.

ii) 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.

iii) There is expected to be little difference between 25 year and 50 year rates therefore borrowing in the 25-30 year periods at the start of the year before rates start to rise could be seen as being more attractive than 50 year borrowing as the spread between the PWLB new borrowing and repayment rates is considerably less. This would maximise the potential for debt rescheduling savings and allow the Council to rebalance its debt maturity profile.

iiii) Variable rate borrowing is expected to be cheaper than long term borrowing and will therefore be attractive throughout the financial year compared to taking long term fixed rate borrowing.

v) Consideration will also be given to borrowing fixed rate market loans (LOBOs) at 25-30 basis points below the PWLB borrowing rates but maintaining an appropriate balance between PWLB and market debt in the debt portfolio.

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.

39. Delegated authority is sought for the Director of Resources to exercise the borrowing powers contained in the Local Government Act 2003 to manage the debt portfolio.

External versus internal borrowing

40. The revised Prudential Code now requires the Council to explain its policy on gross and net debt. The Council currently has gross debt of £280 million and net debt (after deducting cash balances) of £175.5 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.

41. 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.

42. 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. This situation will be monitored in case the differential is narrowed by the PWLB or repayment rates rise significantly.

43. Against this background caution will be adopted with the 2010/11 treasury operations. The Director of Resources 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

44. 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.

45. 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.

Debt Rescheduling

46. The introduction of a differential in PWLB rates on 1 November 2007 resulting in the rates for new borrowing being lower than rates for early repayment of debt has meant that debt restructuring is now less attractive if achieved through swapping one PWLB loan for one on different rates. 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.

47. There has been much discussion as to whether the size of spread between long term PWLB repayment and new borrowing rates should be revised downwards in order to assist local authorities when carrying out any debt restructuring activities. The PWLB issued a consultation document which suggested options to revise the methodology used to calculate the early repayment rate. This consultation period ended in January 2010 and the Council will monitor developments in this area if any changes are introduced. Any positions taken via rescheduling will be in accordance with the strategy outlined above.

Investment Strategy

48. The Council is required, under CIPFA's Treasury Managements Code of Practice, to formulate an Annual Investment Strategy (Appendix 3). This outlines the Council's approach to:-
    - Security of capital
    - Creditworthiness policy
    - Monitoring of credit ratings
    - Specified and Non Specified Investments
    - Temporary Investments

49. 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.

50. The Council are asked to approve the Investment Strategy set out in Appendix 3.

Minimum Revenue Provision (MRP) Statement

51. In accordance with Statutory Instrument 2008 number 414 and new guidance issued by the Government in February 2008 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 4.

Landsbanki Deposit Update

52. 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 88% of the deposit will be repaid in four instalments of 22% starting in March 2011, with the final payment being made in December 2013. 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. First of all the courts require that the parties go through a process of mediation, if no agreement is reached the case is then heard by the Icelandic District Court. 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 36%.

Leasing

53. In the past the Council has used operating leases to finance the purchase of vehicles and equipment. From the 1st April 2004 the Prudential Code enabled the use of finance leases to purchase such assets without limiting the Council's ability to borrow. The Director of Resources 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

54. The Council proposes to offer 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.

55. It is proposed 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 is proposed to offer to lend up to £10 million to each of these Housing Associations in order to support the building of affordable housing in Shropshire. South Shropshire Housing are keen to move forward, Severnside have appreciated having the offer made but have no plans to take it up at the moment.

56. 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. A further report outlining the details of this proposal will be provided to Members in due course.

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 2009/10 (Council 27 February 2009)

Shropshire Council Capital Programme 2010/11 to 2014/15 (Cabinet 3 February 2010)

Revised MRP Statement (Council 10 December 2009)

Capital Monitoring Report Quarter 3 2009/10 (Cabinet 06 January 2010)

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: Keith Barrow, Leader of Council

Appendices:

1 – Adoption of the revised CIPFA Code of Practice

2 – Prudential Indicators

3 – Council's Annual Investment Strategy

4 – Minimum Revenue Provision Policy Statement

5 – Authorised lending list

6 - Schedules 1-7 Calculations and rationale of Prudential Indicators