AUDIT COMMITTEE	AGENDA ITEM No. 5
7 November 2011	PUBLIC REPORT

Committee Member(s) responsible:	Councillor Seaton, Resources Portfolio Holder	
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TREASURY MANAGEMENT PERFORMANCE INDICATORS

R E C O M M E N D A T I O N S	
FROM : John Harrison, Executive Director Strategic Resources	**Deadline date : N/A**

Audit Committee is asked to

1. To review current performance against the Treasury Management Strategy set in the Medium Term Financial Strategy (MTFS)
2. To approve the revised Prudential Indicators included in the Prudential Code and Treasury Management Strategy 2010 updated for International Financial Reporting Standards (IFRS) impact on the Council's accounting policy with regard to lease arrangements

1. ORIGIN OF REPORT

1.1 The Treasury Management in the Public Services: Code of Practice 2009 recommends that members receive reports on its treasury management polices, practices and activities, including, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close.

1.2 The annual strategy is approved by Council as part of the Medium Term Financial Strategy (MTFS) and the final performance against the strategy is reported to Audit Committee in June alongside the Statement of Accounts. This report forms the mid-year review.

2. PURPOSE AND REASON FOR REPORT

2.1 To report current performance and the forecast outturn position against the strategy.

2.2 The change in the accounting treatment for leases brought about by the implementation of IFRS in 2010/11 has resulted in the Prudential Indicators, included in the Prudential Code and Treasury Management Strategy 2010-15, to be revised. This report sets out these amendments and performance against them.

2.3 This is in accordance with the Committees' Terms of Reference – 2.2.17 - To consider the Council's arrangements for corporate governance and agreeing necessary actions to ensure compliance with best practice.

3. TIMESCALE

Is this a Major Policy Item / Statutory Plan?	**NO**	If Yes, date for relevant Cabinet Meeting	N/A

4. TREASURY MANAGEMENT STRATEGY PRUDENTIAL INDICATORS

4.1 The Prudential Code underpins the system of capital finance. Local authorities determine their own programmes for capital investment in fixed assets that are central to the delivery of quality local public services. Prudential indicators are developed as part of the annual MTFS process to ensure that:

a) capital investment plans are affordable;

b) all external borrowing and other long term liabilities are within prudent and sustainable levels; and

c) treasury management decisions are taken in accordance with professional good advice.

The Council has revised the 2011/12 Prudential Indicators to include the leasing requirements since the Full Council approval of the Medium Term Financial plan on 23rd February 2011, which needs to be approved by the Audit Committee.

For the 2010/11 financial year, all Councils were required to review, and amend where necessary, the accounting treatment for lease arrangements. Where lease arrangements have come 'on to the Balance Sheet' as a result of the IFRS based approach, there is a requirement to adjust the Capital Financing Requirement and the Council will therefore need to ensure their authorised limits and operational boundaries are set accordingly.

The revised Prudential Indicators are attached at Appendix A, and has no impact on General Fund balances.

It is not anticipated for the Council to be significantly impacted by the recent Eurozone crisis or from the recent credit downgrading of British banks. As per the Treasury Management Strategy, the Council is operating a restrictive lending list, where surplus cash is only invested for the short term with the Council's banking provider, other Local Authorities, and the Debt Management Office (DMO).

5. CONSULTATION

5.1 As 'The Prudential Code and Treasury Management Strategy 2011-16' forms part of the annual MTFS, it has undergone full consultation and been through the scrutiny process.

5.2 The Council continues to liaise with its treasury advisors, Sector Treasury Services Ltd, and specifically in relation to its deposits in the UK subsidiaries of the Icelandic banks, with Administrators, the Local Government Association, City Council Members, Members of Parliament and the Press.

6. ANTICIPATED OUTCOMES

As set out in the report.

7. REASONS FOR RECOMMENDATIONS

This report and update is given to the Committee to review performance against the Treasury Management Strategy set in the MTFS, and approve the revised Prudential Indicators.

8. ALTERNATIVE OPTIONS CONSIDERED

The 'The Prudential Code and Treasury Management Strategy 2011-16' is required to be prepared in accordance with the Treasury Management in the Public Services: Code of Practice 2009. This report sets out the performance against the associated indicators. The options are therefore limited.

9. IMPLICATIONS

- The implications arising from this report are to approve the revised Prudential Indicators; and
- To provide the Committee the opportunity to review current performance against the revised Prudential Indicators.

10. BACKGROUND DOCUMENTS

(Used to prepare this report, in accordance with the Local Government (Access to Information) Act 1985)

- The Prudential Code for Capital Finance in Local Authorities – Fully revised second edition 2009, CIPFA
- Treasury Management in the Public Services, Code of Practice and Cross-Sectoral Guidance Notes - Fully revised second edition 2009, CIPFA

Appendix A

Treasury Management Strategy - Prudential Indicators – current performance as at 30th September 2011 and estimated Forecast Outturn

The Prudential Code for Capital Finance in Local Authorities provides a framework for local authority capital finance to ensure that:

(a) capital expenditure plans are affordable,

(b) all external borrowing and other long term liabilities are within prudent and sustainable levels;

(c) treasury management decisions are taken in accordance with professional good practice.

In taking decisions in relation to (a) and (c) above, the local authority is accountable by providing a clear and transparent framework.

The Code requires the Council to set a range of Prudential Indicators for the period of the Medium Term Financial Plan. During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Annual Treasury Management Strategy. The actual outturn for the Prudential Indicators for the financial year to date is detailed below.

The 2010 Code of Practice on Local Authority Accounting introduced a new accounting policy based on International Financial Reporting Standards (IFRS) which re-defines the categories of leases and those defined as operating leases are bought on to the Council's balance sheet. These leases include the long term plant and equipment leases and two investment property leases and these impact on the Council's capital financing.

The IFRS adjustment has no impact on the total expenditure of the Council, it instead changes the way this expenditure is accounted for and shown in the Council's accounts, which in turn impacts on Prudential Indicators.

The 2011/12 Prudential Indicators are shown below have been revised to include finance leases and the Council's performance to date against them. All performance is within the limits.

1. Indicator One: Adoption of the CIPFA Code of Treasury Management in the Public Services

The Council adopted the CIPFA Code of Treasury Management in the Public Services in 2002, and the revised code in 2009. Treasury Management Practices (TMP's) have been established with advice from Sector Treasury Services and applied to the Council's treasury management activities.

2. Indicator Two: Estimates and actual Capital Expenditure 2011/12

	Indicator	As at Sept-11	Forecast Outturn
2011/12 Capital Expenditure	£108.8m	£27.8m	£98.0m

This indicator is the estimated capital expenditure for the year based on the Capital Programme for that period.

3. **Indicator Three: Estimates of actual capital financing requirements and net borrowing**

The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow money in the long term for capital purposes. It is calculated from various capital balances in the Council's Balance Sheet.

	Indicator	Leases	Revised Indicator	As at Sept-11	Forecast Outturn
2011/12 CFR	£266.4m	£3.5m	£269.9m	£234.0m	£258.8m

4. **Indicator Four: Affordability (1) Estimate of actual ratio of financing costs to net revenue stream**

The Council must estimate the proportion of the revenue budget, which is taken up in financing capital expenditure i.e. the net interest cost and to make provision to repay debt.

	Indicator	Leases	Revised Indicator	As at Sept-11	Forecast Outturn
2011/12 Financing costs to revenue stream	4.6%	0.5%	5.1%	4.7%	4.8%

This is because the change in accounting treatment has no additional impact on the Council's revenue expenditure.

5. **Indicator Five: Affordability (2) Estimate of the incremental impact of capital investment decisions on the Council Tax**

This indicator is intended to show the impact of the Council's decisions about capital investment on the level of Council Tax required to support those decisions over the medium term.

The calculation of this indicator has been done of the basis of the amount of the capital programme that was financed from borrowing. The calculation is based on the interest assumption for borrowing that was included in the capital financing budget. The revenue costs are divided by the estimated Council Taxbase for the year:

	Indicator	Leases	Revised Indicator	As at Sept-11	Forecast Outturn
2011/12 Incremental impact on Council Tax	£1.09	-	£1.09	£(27.49)	£(20.91)

The overall impact of the leases for this Prudential Indicator is zero. This is because the change in accounting treatment has no additional impact on the Council's revenue expenditure. The difference between the indicator and the forecast outturn is because the Council's cash balances were greater than estimated at budget setting. This means the Council can amend the timing of borrowing and therefore incur less interest costs during the year.

6. **Indicators Six: External Debt Prudential Indicators**

The Authorised Limit represents the maximum amount the Council may borrow at any point in time in the year. It is set at a level the Council considers is "prudent".

The indicator takes account of the capital financing requirement estimated at the start of each year, plus the expected net borrowing requirement for the year.

This makes allowance for the possibility that the optimum time to do all borrowing may be early in the year.

The limits also incorporated margins to allow for exceptional short-term movements in the Council's cash flow, bids from service departments to finance efficiencies, changes to the timing of capital payments and fluctuations in the realisation of capital receipts.

The Council have not taken out any new borrowing in 2011/12 to date. The £180.2m is broken down into £134.5m of long term borrowing, £39.9m PFI, £3.5m leases and £2.3m other long term liabilities.

	Indicator	Leases	Revised Indicator	As at Sept-11	Forecast Outturn
2011/12 Authorised limit for external debt	£378.8m	£3.5m	£382.3m	£180.2m	£194.6m
2011/12 Operational Limit for external debt	£279.0m	£3.5m	£282.5m	£180.2m	£194.6m

It is ultra vires to exceed the Authorised Limit so this should be set to avoid circumstances in which the Council would need to borrow more money than this limit. However, the Council can revise the limit during the course of the year.

The Operational Limit is a measure of the day to day likely borrowing for the Council, whereas the Authorised Limit is a maximum limit. The code recognises that circumstances might arise when the operational limit might be exceeded temporarily, but if this continues for a lengthy period then it ought to be investigated.

The following indicators take into consideration the capital programme over the life of the MTFS and the ability to phase the borrowing over this period. The indicators provide flexibility for the Council to take advantage favourable interest rates in advance of the timing of the actual capital expenditure. The forecast outturn does not represent the actual debt position at year end.

7. Indicator Seven: Variable interest rate exposure

This indicator places an upper limit on the total amount of net borrowing (borrowing less investment) which is at variable rates subject to interest rate movements. The intention is to keep the variable rate borrowing below 25% of the total gross borrowing (CFR).

The limit is expressed as the value of total borrowing less investments

As no new borrowing has taken place this financial year the indicator is zero for variable rate borrowing

	Indicator	As at Sept-11	Forecast Outturn
2011/12 Upper limit for variable rate exposure	£56.6m	0	0

8. Indicator Eight: Fixed Interest rate exposures

This indicator places an upper limit on the total amount of net borrowing which is at fixed rates secured against future interest rate movements. The upper limit allows flexibility in applying a proportion of the investment portfolio to finance new capital expenditure. It also reflects a position where the great majority of borrowing is at fixed rate which provides budget certainty with 100% of borrowing being at fixed rate. The upper limit for fixed interest rate exposure was set to allow for flexibility in applying a proportion of the investment portfolio to finance new capital expenditure. It also reflected a position where the great majority of borrowing was at fixed rates to provide budget certainty.

So far during this financial year no new borrowing has taken place, however given the forecast outturn for capital expenditure at £98.0m, the borrowing requirement for the remainder of the year is estimated to be an additional £14.4m.

	Indicator	**As at Sept-11**	**Forecast Outturn**
2011/12 Upper limit for fixed rate exposure	£338.9m	£136.8m	£151.2m

9. Indicator Nine: Prudential limits for the maturity structure of borrowing

The prudential limits have been set with regard to the maturity structure of the Council's borrowing, and reflected the relatively beneficial long term rates that were expected to be available over the next few years. The limits were as follows:

Period	**Upper Limit Estimate**	**Lower Limit Estimate**	**Actual Borrowing**
Under 12 months	40%	0%	14.21%
1 - 2 years	40%	0%	0%
2 - 5 years	80%	0%	0%
5 - 10 years	80%	0%	0%
over 10 years	100%	10%	85.79%

10. Indicator Ten: Total Investments for periods longer than 364 days

Authorities are able to invest for longer than 364 days; this can be advantageous if higher rates are available. However it would be unwise to lend a disproportionate amount of cash for too long a period particularly as the Council must maintain sufficient working capital for its operational needs.

The Executive Director - Strategic Resources has therefore sought the advice of Sector Treasury Services Ltd, the Council's treasury advisors, who recommended that, given the structure of the Council's balance sheet and its day to day cash needs, it would be reasonable to maintain the limit for investments with life spans in excess of 1 year to £25 million. Consequently it is proposed to keep the limit for investments that may be deposited for more than 1 year at £25 million for 2011/12 and later years.

The Council currently has no investments of more than 364 days.

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