STRATEGIC OVERVIEW AND SCRUTINY COMMITTEE

31 August 2011

Agenda Item : 6

Contact Officer: Jane Kitchen
Anthony Thomas

Telephone: 01543 308770
01543 308012

SUBMISSION BY CLLR MJ WILCOX, THE LEADER OF THE COUNCIL & THE PORTFOLIO HOLDER FOR FINANCE, REVENUES & BENEFITS

Annual Report on Treasury Management Services and Actual Prudential Indicators 2010/11

1. Purpose of Report

Background

1.1 The Annual Treasury Report is a requirement of the Council's reporting procedures. It covers the Treasury activity during 2010/11 and the actual Prudential Indicators for 2010/11.

1.2 Our treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members be informed of treasury management activities at least twice a year. We report quarterly to the Cabinet and scrutiny on treasury policy, strategy and activity is delegated to the Strategic (Overview and Scrutiny) Committee.

1.3 Treasury management is defined as: "The management of the local 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."

1.4 Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to our treasury management objectives.

Scope

1.5 This report is prepared in accordance with the revised CIPFA Treasury Management Code and the revised Prudential code and;

- a) presents details of capital spend, capital financing, borrowing and investment transactions;
- b) reports on the risk implications of treasury decisions and transactions;
- c) gives details of the outturn position on treasury management transactions in 2010/11;
- d) confirms compliance with treasury limits and Prudential Indicators and
- e) provides details of the results of recent reviews undertaken in relation to Treasury Management Activity to provide assurance that systems and controls work as expected.

1.6 The report is to full Council and is in addition also being submitted to Strategic (Overview and Scrutiny) Committee who are responsible for scrutiny of the Treasury Management function.

2. Background

2.1 Interest Rates and Investment Strategy

- At the time of determining our strategy for 2010/11, interest rates were expected to remain low in response to the fragile state of the UK economy. The central interest rate assumption used in our budget for 2010/11 was 0.5%.
- This interest rate was used as the basis for compiling our investment income budget. In order to mitigate the risk that interest rates would remain low over 2010/11 we spread the maturity dates for our investments up to a period of 364 days. This was done to take advantage of better yields, whilst not compromising the security of our investments. The outcome of this was there was no significant impact on our investment income regardless of the direction interest rates followed.
- In addition, where we had a borrowing need, this was funded by reducing the level of our external investments. This approach minimised the cost of any borrowing to the Council. External borrowing would have cost c5%. By internally borrowing, the cost to the Council was the loss of interest that would have been earned had this money been invested externally, c1%. Effectively, an overall saving in borrowing costs of c4% or **£68k**.

2.2 Investment Strategies Approved Covering the 2010/11 Financial Year

- Council approved two Investment Strategies during 2010/11 and these are shown in **APPENDIX A**.
- The changes to the Investment Strategy demonstrated how we monitored and updated our strategies on an ongoing basis, seeking Full Council approval for any significant changes.
- These Strategies also showed how we strengthened our investment criteria to ensure the safe return of our investments.

2.3 Investments and Cash flow

- The investments that the Council had outstanding together with a summary of investment activity throughout the 2010/11 financial year and the maturity profile of our investments compared to interest rate projections are shown at **APPENDIX B**.
- The summary of our investment activity shows that our current list of institutions is short and this reflects the suitability of counter parties available for the Council to invest its monies with. This is a reflection of the credit crunch and the ongoing challenges in the banking sector.
- Our actual average cash flow in 2010/11 was within **11%** of our projected budget (**APPENDIX B)**.
- We received **£203K** in net investment income in 2010/11, compared with a revised Budget of **£191K**, an additional **£12K** investment income generated.
- No new external borrowing was made in 2010/11.

2.4 The Performance of and Training within the Treasury Management Function

- The performance of the Treasury Management function needs to be measured against our investment objectives of Security (the safe return of our monies), Liquidity (making sure we have sufficient money to pay for our services) and Yield (the return on our investments) and these are shown in detail at **APPENDIX C**.
- Our aim for the risk status of our investments was **A+** and our investments at the 31st March 2011 had a more secure risk status of **AA-** based on both the length and value of the investments**.**
- We achieved an average yield of **0.85%** and this compares to our performance indicator of the average 7-day London Inter-bank Bid (LIBID) rate, which was **0.43%**, the 1 month rate was **0.50%,** the 3 month rate was **0.67%** and the 6 month rate was **0.98%.**
- Details of training within the Treasury Management function are outlined in **APPENDIX C**.

2.5 Balance Sheet

- The actual Balance Sheet and Balance Sheet Summary compared with the projected Balance Sheet as at 31 March 2011 are shown at **APPENDIX D**.

- The reasons for the major variances between actual and projections are also shown at **APPENDIX D**.

2.6 Treasury Position

- Our investments continue to exceed our external debt. They have increased from **£9.545m** on 31 March 2010 to **£10.130m** on 31 March 2011 and the reasons for this increase are shown in the Balance Sheet commentary (**APPENDIX D**).
- Our Treasury Position as at 31 March 2011 is set out at **APPENDIX E**.

2.7 Prudential indicators 2010/11

- Our actual Prudential Indicators are shown in detail at **APPENDIX F** and are summarised in the financial implications section of this report.
- The main variation is the Actual Capital Financing Requirement of **£3.844m** compared with Budget of **£1.501m,** a variation of **£2.343m**. The majority of this variation was due to Chasewater Dam **£2.053m**. The Budget assumed the responsibility and costs of repair to Chasewater Dam were to be transferred on or before 31 March 2011 to Staffordshire County Council. This actual transfer of responsibility took place on 18 April 2011. As a consequence, in 2010/11 this created a borrowing need financed by internal borrowing.

2.8 Treasury Management Assurance

- One of the key questions for Members in relation to Treasury Management is:

  "How can I be assured that agreed Treasury Management Strategies, Policies and Limits are being applied correctly within the Council?"

- The answer to this question is provided by reviews that are undertaken by both independent internal and external bodies: these are shown in detail at **APPENDIX G**.
- Two reviews were recently undertaken in relation to Treasury Management:

  1) The review of Treasury Management – 2010/11 by Internal Audit - Overall Audit Opinion – **Substantial Assurance**[1].
  2) Treasury Management Strategy – Our Treasury Management Advisors comments were: "Lichfield has a very tailored, understandable Treasury Strategy Statement. It is good to see any new issues or changes are highlighted to members in a clear manner, without jargon".

3. Community Benefits

3.1 Management of the Council's resources is essential in order to ensure economical and efficient delivery of Council services.

4. Financial Implications

4.1 The Prudential Indicators are shown in detail at **APPENDIX F** and are summarised on the following table :

[1] The scale of assurance is excellent, substantial, adequate, limited and poor.

Prudential Indicator	Capital Expenditure	Revised Estimate 2010/11	Actual 2010/11
1	Capital Expenditure **(£m)**	10.181	6.747
2	Ratio of Financing Costs to Net Revenue Stream (**%**)	0[2]	3
3	Capital Financing Requirement (**£m**)	1.501	3.844
	Net External Borrowing does not exceed the Capital Financing Requirement in the current and next 2 years	True	True
4	Actual External Debt (**£m**). Borrowing and Finance Leases	0	1.803
5	Incremental impact of Capital Investment Decisions on Band D Council Tax (**£**)	0	0.67
6	Authorised Limit (**£m**) (Maximum)	11.849	2.190
7	Operational Boundary (**£m**) (Maximum)	2.987	2.190
8	Adoption of CIPFA Code of Practice in Treasury Management	True	True
	Interest Rate Exposure (**%**)		
9	Upper Limit for Investments Fixed Interest Rate Exposure	(100)	(92)
	Upper Limit for Investments Variable Interest Rate Exposure	(75)	(49)
10	Upper Limit for Borrowings Fixed Interest Rate Exposure	100	100
	Upper Limit for Borrowings Variable Rate Interest Exposure	30	0
11	Maturity Structure of Fixed Rate Borrowing (Upper Limit) (**%**)	100	13
	Under 12 months	20	13
	12 months and within 24 months	80	74
	24 months and within 5 years	40	0
	5 years and within 10 years	60	0
	10 years and within 20 years	40	0
	20 years and within 30 years	40	0
	30 years and within 40 years	40	0
	40 years and within 50 years	20	0
	50 years and above		
12	Principal sums invested >364 days (**£m**)	2.300	0

5. Risk Management Issues

	Risk Description	Likelihood / Impact	Status	Countermeasure
A	Counterparty default	Medium / High	Financial	Investments are restricted to those organisations with the lowest credit risk: a) The Debt Management Agency Deposit Facility. b) Money Market Funds with an AAA rating. c) Deposits with other Local Authorities. d) Business Reserve and Term Deposits with a long term credit rating of A+. As conditions in the Financial Sector improve, we may diversify the counterparty list based on our advisor's recommendations.
B	Adverse Interest Rate fluctuations	Low / Low	Financial	The budget for investment income will be monitored as part of the Council's budget monitoring procedures.
C	Actual cash flows are different to those that are planned	Low / High	Financial	The Council maintains a comprehensive cash flow model that is updated on a daily basis to reflect both actual and planned cash flows. An element of the Council's investment portfolio will be invested in call accounts.
D	Planned capital receipts are not received	Medium / High	Financial	The budget for capital receipts will be monitored as part of the Council's budget monitoring procedures.

Background Documents:

CIPFA Code of Practice for Treasury Management in the Public Services Treasury Management Strategy Report 2010-15 – Cabinet 9 February 2010. Half Year Report on Treasury Management Services and Projected Prudential Indicators 2010/11 – Cabinet 2 November 2010 Treasury Management Strategy Report 2011-14 – Cabinet 1 February 2011.
The Prudential Code for Capital Finance in Local Authorities

Investment Strategies Approved Covering the 2010/11 Financial Year.

Full Council approved two Investment Strategies during 2010/11 and these are shown in the tables below:

Specified Investments[3]

Financial Asset Category	**Strategy Approved 22nd February 2011**		**Strategy Approved 23rd February 2010**	
	Minimum Criteria	**Limits**	**Minimum Criteria**	**Limits**
UK Banks and Building Societies	Minimum Short Term Rating Fitch = F1 Moody's = P-1 Standard and Poors = A-1 Minimum Long Term Rating Fitch = A+ Moody's = A1 Standard and Poors = A+	£2 million and subject to Arlingclose advice	Minimum Short Term Rating Fitch = F1 Moody's = P-1 Standard and Poors = A-1 Minimum Long Term Rating Fitch = A+ Moody's = A1 Standard and Poors = A+	£3 million / less than 1 year and subject to Arlingclose advice
Deposits with Money Market Funds	Fitch = AAAmmf Moodys = Aaa/MR1+ Standard and Poors = AAAm	£2 million	Fitch = AAAmmf Moodys = Aaa/MR1+ Standard and Poors = AAAm	£1.5 million
UK Government	Not applicable	No limit	Not applicable	No limit
Local Authorities, Parish Councils etc	Not applicable	No limit	Not applicable	No limit

Group Limit	£3 million	£4 million
Money Market Funds Limit	£10 million	£6 million
Sovereign Limit	100% UK	100% UK

Non Specified Investments

Financial Asset Category	**Strategy Approved 22nd February 2011**		**Strategy Approved 23rd February 2010**	
	Minimum Criteria	**Limits**	**Minimum Criteria**	**Limits**
The Council's own bank (where credit ratings are not sufficient)	Now a specified investment		Not applicable	£100,000
Deposits with a maturity of greater than one year	Minimum Short Term Rating Fitch = F1+ Moody's = P-1 Standard and Poors = A-1+ Minimum Long Term Rating Fitch = AA- Moody's = Aa3 Standard and Poors = AA-	£2.3 million	Minimum Short Term Rating Fitch = F1+ Moody's = P-1 Standard and Poors = A-1+ Minimum Long Term Rating Fitch = AA- Moody's = Aa3 Standard and Poors = AA-	£2.5 million
Group Limit	£3 million		£4 million	
Sovereign Limit	100% UK		100% UK	

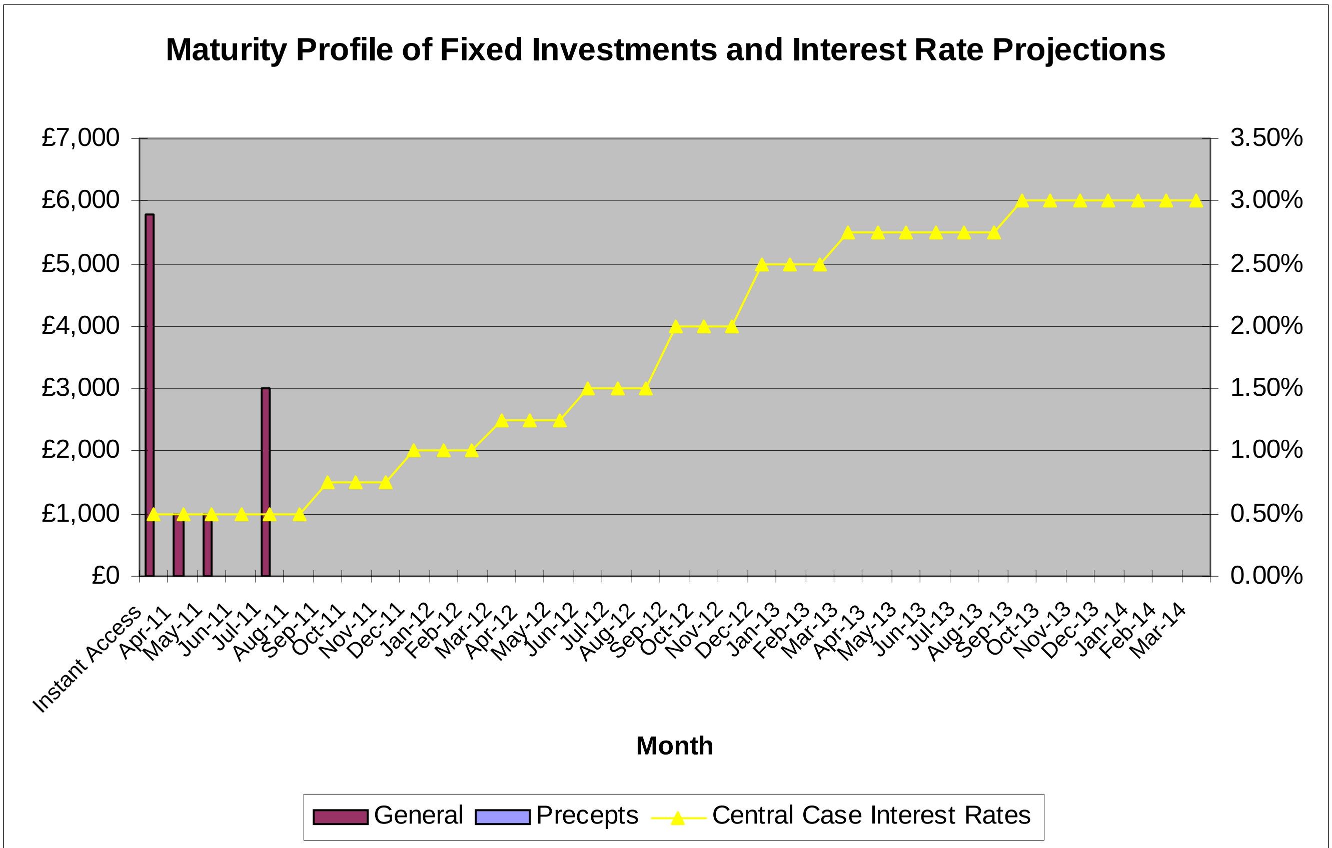
Investments and Cash Flow in 2010/11

Investments at 31 March 2011

The table below shows a breakdown of our investments at the end of the financial year:

Counterparty	Principal	Matures	Days to Maturity	Rate	Credit Rating[4] 31.03.11	Foreign Parent
Santander UK	£1,000,000	8 Apr 2011	8	0.91%	AA-	Yes
Bank of Scotland	£1,000,000	18 Apr 2011	18	1.12%	A+	No
Barclays Bank	£1,000,000	20 Jul 2011	111	1.41%	AA-	No
Barclays Bank	£1,000,000	11 May 201	41	1.22%	AA-	No
Lloyds TSB	£2,000,000	20 Jul 2011	111	1.95%	A+	No
Lancashire County Council	£1,000,000	18 Apr 2011	18	0.60%	AAA	No
Yorkshire Bank	£400,000	05 Apr 2011	15 Day Call Account	0.75%	A+	Yes
Royal Bank of Scotland	£2,000,000	01 Apr 2011	Call Account	0.80%	A+	No
Standard Life	£730,000	01 Apr 2011	Money Market Fund	0.58%	AAA	N/A
Total	**£10,130,000**					

The graph below compares the current maturity profile of our investments at the 31st March 2011 to our projections for interest rates. This shows we are continuing to keep the maturity profile of our portfolio relatively short to manage the risks of interest rate increases together with enabling us to be able to react to changes in the credit risk of counterparties.



However, the previous table and graph only shows the investment position on one particular day of the financial year, the table below shows a summary for the whole of the financial year:

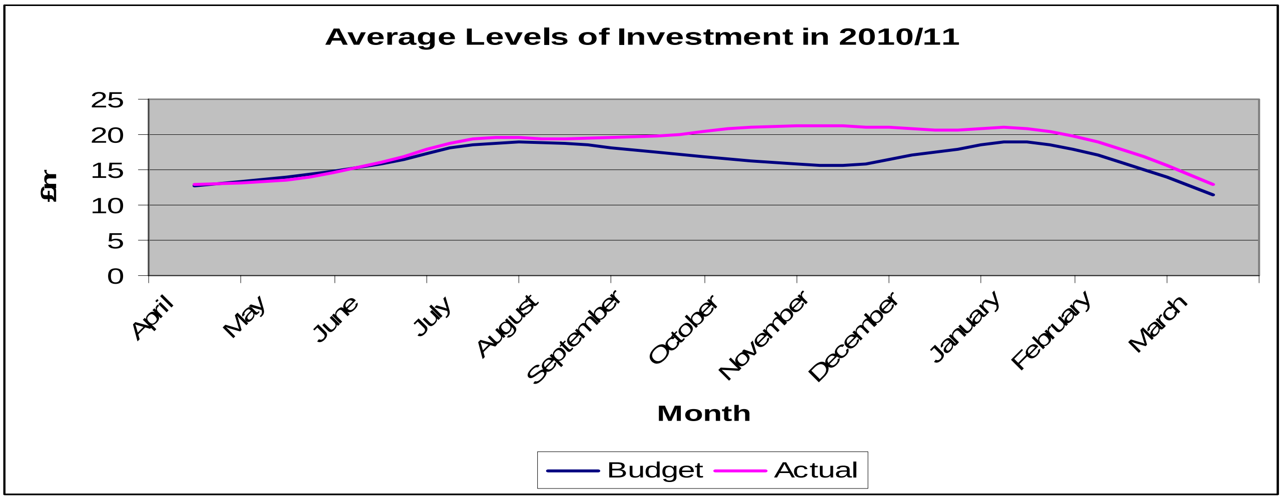
Counterparty	Number of Deals	Total Principal Invested	Is the Counterparty on our current list of eligible institutions?
Debt Management Office	7	£16,440,000	Yes
Santander UK	9	£15,001,478	Yes
Standard Life	41	£14,750,000	Yes
Blackrock	24	£13,175,000	Yes
Invesco	29	£11,560,000	Yes
Lancashire County Council	4	£8,730,000	Yes
JP Morgan	20	£8,400,000	Yes
Clydesdale Bank (including Yorkshire Bank)	15	£8,145,000	Yes
Nationwide	3	£5,150,000	Yes
Royal Bank of Scotland	13	£4,424,000	Yes
Leeds City Council	1	£4,350,000	Yes
London Borough of Brent	1	£4,250,000	Yes
Bank of Scotland	5	£3,305,000	Yes
Barclays Bank	3	£3,000,000	Yes
Sheffield City Council	1	£2,800,000	Yes
Eastleigh Borough Council	2	£2,750,000	Yes
Lloyds TSB	1	£2,000,000	Yes
Goldman Sachs	1	£190,000	Yes
Total	**180**	**£128,420,478**	

This list is reviewed on an ongoing basis and takes account of the following sources of information:

- Advice from our Treasury Management advisors.
- Credit Ratings.
- Credit Default Swaps prices.
- Share Prices.
- Information in the general and financial media.

Cash flow for 2010/11

The graph below compares the budget for average investment levels in 2010/11 with the actual levels.



The graph shows that the actual trend of investments followed the budgeted trend quite closely.

Investment Income and Borrowing Cost Budgets for 2010/11

Net Investment Income

In terms of interest receipts, there are two key risks/sensitivities:

a) The interest rate receivable.
b) The amount of money we have available to invest.

The interest rates, amounts of money we had available to invest, interest receipts, interest paid and net investment income is shown in the table below:

	Original 2010/11	Revised Budget 2010/11	Actual 2010/11
Average Amount we had available to invest (**£m**)	16.09	15.24	17.95
Average Interest Rate (**%**)	0.60	0.95	0.85
Net Investment Income			
Interest Receipts	(£171,770)	(£196,740)	(£206,157)
Borrowing Costs – Minimum Revenue Provision	£94,000	£0	£0
Borrowing Costs – External Interest	£160,000	£0	£0
Interest Paid	£6,000	£6,190	£2,912
Net Investment Income - Total	**£88,230**	**(£190,550)**	**(£203,245)**

New External Borrowing Costs

No new external borrowing was undertaken in 2010/11.

Performance of the Treasury Management Function

The performance of the Treasury Management function should be measured against the investment objectives of Security (the safe return of our monies), Liquidity (making sure we have sufficient money to pay for our services) and Yield (the return on our investments).

Security

Our aim for the risk status of our portfolio was **A+** utilising the lowest rating from the three credit rating agencies**.**

The investments outstanding at the 31 March 2011 had a risk status of **AA-** based on the length of the investment and **AA-** based on the value of the investment, which is a more secure risk status, and this is both compliant with our aim and the recommendations from our Treasury Management advisors.

In addition, we are currently keeping the length of our investments relatively short term to ensure that we can react to changes in counterparty credit risk very easily. Our Treasury Management advisors have recommended investments are for no longer than **1 year** in duration to manage counterparty credit risk. However, an exception has been made with Barclays and HSBC Banks where we are able to undertake investments up to **2 years**. We also maintained balances in Money Market Funds and Instant Access Accounts to provide for unforeseen cash flow requirements.

The average length of investments we made in 2010/11 was **72 days**.

Liquidity

Measuring the performance in relation to liquidity is a much more difficult task and the easiest way to assess performance is to see how frequently we needed to borrow on a temporary basis during the financial year. In 2010/11 we did not need to temporarily borrow.

Yield

In 2010/11 we achieved an average interest rate of **0.85%** and this compares to our performance indicator of the average 7-day London Inter-bank Bid (LIBID) rate, which was **0.43%**, the 1 month rate was **0.50%,** the 3 month rate was **0.67%** and the 6 month rate was **0.98%.**

Training within the Treasury Management Function

Our Treasury Management Practices (TMP 10) states “This organisation recognises the importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to appoint individuals who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills. The Director of Finance, Revenues and Benefits will recommend and implement the necessary arrangements.”

We have two points of access for training:

- Our Treasury Management Advisors run regular courses and we are entitled to two free places on each course.
- We are members of the CIPFA Treasury Management Forum and this entitles us to four places on various courses as part of our membership subscription.

During 2010/11 a total of **5** courses were attended. These courses addressed skills including the Principles of Treasury Management Workshop to Moving Forward – the ongoing pursuit of risk based treasury management.

APPENDIX D

Balance Sheet - in IFRS Format with latest changes

Balance Please note IFRS adjustments include latest changes and are subject to External Audit	**31 Mar 2010 Actual £m**	**31 Mar 2011 Actual £m**	**31 Mar 2011 Final Budget £m**	**Variance To Final Budget £m**
1. Property, Plant and Equipment, Investment Property & Intangible Assets	47.606	50.649	49.403	1.246
4. Long Term Debtors	0.189	0.359	0.063	0.296
Current Assets				
4. Current Assets (including accrued interest)	8.114	5.838	3.654	2.184
2. Short Term Investments (excluding accrued interest)	9.000	7.400	8.506	1.624
2. Cash and Cash Equivalents	0.439	2.730		
Current Liabilities				
3. Short Term Borrowing	(0.006)	(0.005)	(0.005)	0
3. Finance Leases	(0.500)	(0.523)	0	0.156
1. Deferred Income	0	0	(0.679)	
4. Short Term Creditors	(5.055)	(6.679)	(5.006)	(1.673)
4. Provisions	(0.079)	0	(0.079)	0.079
4. Receipts in Advance	(1.089)	(0.614)	(0.920)	0.306
Long Term Liabilities				
3. Finance Leases	(1.516)	(1.240)	(1.462)	0.222
3. Borrowing	(0.039)	(0.034)	(0.034)	0
4. Pension Scheme	(36.373)	(20.187)	(36.373)	16.186
4. Receipts in Advance	(0.459)	(0.863)	(0.472	-0.391
Total Assets less Liabilities	**20.232**	**36.831**	**16.596**	**20.235**

Usable Reserves				
4. Capital Grants Unapplied	2.190	1.636	0	1.636
5. Usable Capital Receipts	2.445	2.087	1.706	0.381
5. Burntwood Leisure Centre Sinking Fund	0.739	0.664	0.537	0.127
5. Burntwood Synthetic Pitch Sinking Fund	0.029	0.029	0.029	0
5. City Centre Redevelopment Sinking Fund	0.025	0.025	0.025	0
5. King Edwards Leisure Centre Sinking Fund	0.031	0.031	0.031	0
5. Lombard Street Car Park Sinking Fund	0.017	0.017	0.017	0
5. Elections	0.105	0.095	0.105	-0.010
5. Public Open Spaces	0.007	0.007	0.007	0
5. Three Spires Multi Storey Reserve	1.447	0.994	0.992	0.002
5. Earmarked Reserves	1.494	1.419	0.985	0.434
5. Grant Aid	0.035	0.038	0.035	0.003
5. Depot Relocation	0.050	0	0	0
5. General Fund Balance	3.321	3.406	1.518	1.888
Unusable Reserves				
1. Revaluation Reserve	5.100	4.932	1.900	3.032
1. Capital Adjustment Account	39.875	41.873	45.323	(3.450)
4. Deferred Credits	0.012	0.011	0.010	0.001
4. Benefits Payable during Employment	(0.261	(0.232)	(0.201)	(0.031
5. Collection fund	(0.056	(0.014)	(0.050)	0.036
4. Pension Scheme	(36.373	(20.187)	(36.373)	16.186
Total Equity	**20.232**	**36.831**	**16.596**	**20.235**

Balance Sheet Summary

1. Capital Financing Requirement	2.631	3.844	1.501	2.343
2. Investments	9.545	10.130	8.506	1.624
3. Borrowing and Finance Leases	(2.153)	(1.802)	(1.501)	(0.301)
4. Net Creditors	(0.808)	(3.374)	(2.569)	(0.805)
5. Balances and Reserves	(9.215)	(8.798)	(5.937)	(2.861)

Balance Sheet Commentary

The main changes to the budget and its assumptions that impacted on the Balance Sheet are detailed below:

Capital Programme

The Capital Programme under spent the Final Budget by £3.434m of which £2.236m related to non current assets (fixed assets) and £1.198m related to Revenue Expenditure funded from Capital under Statute.

This also meant that the funding we budgeted to use from grants and contributions and capital receipts was reduced.

In addition, the spend included £1.443m plus £0.610m related to previous years in relation to Chasewater Dam that was budgeted to be reimbursed by Staffordshire County Council. However, the transfer of Chasewater was not completed before the end of the 2010/11 Financial Year and therefore this fund was funded by “internal borrowing” through reducing the level of our investments.

Revenue Budget

The Revenue Budget under spent the Final Budget by £0.085m including a net transfer from earmarked reserves of £(0.535)m.

Pensions

The triennial valuation of the pension fund took place in 2010/11 using new assumptions such as CPI etc and this valuation has resulted in the Pension scheme liability reducing from £36.373m to £20.187m.

Creditors

The level of creditors has increased because there has been a reduction in the payments of Housing and Council Tax benefits and therefore a refund of £1.08m is due to the Department of Works and Pensions for grant received.

Treasury Portfolio

The Balance Sheet can also be used to assess the underlying need to borrow (known as the Capital Financing Requirement). The table below shows that we had sufficient balances and reserves to mean we did not need to undertake any long-term borrowing. Based on approved budgets and the average interest rate we achieved on investments of 0.85%, this approach has saved the Council circa **£68,000**.

Our Borrowing Need was higher than budgeted because we assumed that all of the spend in relation to the Chasewater Dam project would be reimbursed before the end of the Financial Year. However, the transfer of this asset to Staffordshire County Council did not take place until 2011/12 and therefore this spend had not been reimbursed and was financed by reducing the level of our investments.

31 Mar 2010 Actual £m		31 Mar 2011 Original £m	31 Mar 2011 Revised £m	31 Mar 2011 Final Budget £m	31 Mar 2011 Actual £m
2.631	The amount of our capital spend that is not financed from capital receipts, revenue, grants and contributions (Capital Financing Requirement)	4.543	1.501	1.501	3.844
-2.153	Less: current funding provided through finance leases and long term borrowing	(0.105)	(1.501)	(1.501)	(1.803)
0.478	**Borrowing Need**	**4.438**	**0**	**0**	**2.041**
-9.215	Less: the projected level of our balances and reserves we currently hold as investments	(5.738)	(5.937)	(5.937)	(8.798)
-8.737	**Our net borrowing need (a positive figure indicates when we need to borrow)**	**(1.300)**	**(5.937)**	**(5.937)**	**(6.757)**

Our current Balance Sheet projections indicate we could continue to follow this strategy for the medium term. However, we will need to constantly review these projections in line with changes to our budgets.

COMPLIANCE WITH PRUDENTIAL INDICATORS 2010/11

1 Background:

There is a requirement under the Local Government Act 2003 for Local Authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators. It should be noted that CIPFA undertook a review of the Code in early 2008 and issued revised Code in November 2009.

The Council implemented its strategy within the limits and parameters set in its treasury policy, strategy statement and Prudential Indicators against the prevailing market conditions and opportunities as follows:

(a) Financing its capital spending from government grants / usable capital resources / revenue contributions, etc. rather than from external borrowing.

(b) Adhering to the paramount requirement of safeguarding the council's invested balances during a period of unprecedented money market dislocation; maintaining adequate diversification between institutions; optimising investment returns subject to the overriding requirement of security and liquidity.

(d) Forecasting and managing cash flow and undertaking short-term borrowing and lending to preserve the necessary degree of liquidity.

2. Net Borrowing and the Capital Financing Requirement:

This is a key indicator of prudence. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Local Authority should ensure that the net external borrowing does not, except in the short term, exceed the total of Capital Financing Requirement in the preceding year plus the estimates of any additional Capital Financing Requirement for the current and next two financial years.

The Director of Finance, Revenues and Benefits reports that the Authority had no difficulty meeting this requirement in 2009/10, nor are there any difficulties envisaged for future years.

3. Estimates of Capital Expenditure (Prudential Indicator 1):

3.1 This indicator is set to ensure that the level of proposed Capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax.

Capital Financing	2010/11 Original £m	2010/11 Revised £m	2010/11 Final Budget £m	2010/11 Actual £m
Fixed Assets	6.020	7.421	7.500	5.255
Revenue Expenditure Funded from Capital under Statute	2.070	3.162	2.681	1.492
Total	**8.090**	**10.583**	**10.181**	**6.747**

3.2 This capital expenditure has been financed as follows:

Capital Financing	2010/11 Original £m	2010/11 Revised £m	2010/11 Final Budget £m	2010/11 Actual £m
Capital receipts	0.988	1.013	0.984	0.634
Burntwood Sinking Fund	0.175	0.202	0.202	0.074
Capital Grants and Contributions	4.100	8.709	8.313	3.602
Revenue contributions and earmarked reserves	0	0.646	0.669	0.721
Unsupported borrowing	2.827	0.013	0.013	1.716
Total	**8.090**	**10.583**	**10.181**	**6.747**

4. Ratio of Financing Costs to Net Revenue Stream (Prudential Indicator 2):

4.1 This is an indicator of affordability and demonstrates the revenue implications of capital investment decisions by highlighting the proportion of the revenue budget required to meet the borrowing costs associated with capital spending. The financing costs include existing and proposed capital commitments.

4.2 The ratio is based on costs net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2010/11 Original %	2010/11 Revised %	2010/11 Final Budget %	2010/11 Actual %
General Fund	2	0[5]	0	3
Total	**2**	**0**	**0**	**3**

5. Capital Financing Requirement (Prudential Indicator 3):

5.1 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council ensures that net external borrowing does not, except in the short term, exceed the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years.

Capital Financing Requirement	2010/11 Original £m	2010/11 Revised £m	2010/11 Final Budget £m	2010/11 Actual £m
General Fund	3.537	1.501	1.501	3.844
Total	**3.537**	**1.501**	**1.501**	**3.844**

6. Actual External Debt (Prudential Indicator 4):

6.1 This indicator is obtained directly from the Council's Balance Sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

No. 4	Actual External Debt as at 31/03/2011	Short Term £	Long Term £	Total £
	Borrowing	5,000	34,965	39,965
	Finance Leases	520,685	1,242,306	1,762,991
	Total	**525,685**	**1,277,271**	**1,802,956**

7. Incremental Impact of Capital Investment Decisions (Prudential Indicator 5):

7.1 This is an indicator of affordability that shows the impact of Capital investment decisions on Council Tax levels when the budget for the year was set.

Incremental Impact of Capital Investment Decisions	2010/11 Original £	2010/11 Revised £	2010/11 Final Budget £	2010/11 Actual £
Incremental Impact of Capital Investment Decisions	6.60	0	0	0.67
Total	**6.60**	**0**	**0**	**0.67**

8. Affordable Borrowing Limit, Authorised Limit and Operational Boundary for External Debt:

8.1 The Council has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy and practice. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Council and not just those arising from capital spending reflected in the CFR.

8.2 The **Authorised Limit (Prudential Indicator 6):** This is the maximum amount of external debt that can be outstanding at one time during the financial year. The limit, which is expressed gross of investments, is consistent with the Council's existing commitments, proposals for capital expenditure and financing and with its approved treasury policy and strategy and also provides headroom over and above for unusual cash movements. This limit was originally set at **£13.914m** and revised to **£11.849m** for 2010/11.

8.3 **Operational Boundary (Prudential Indicator 7)**: This is limit is set to reflect the Council's best view of the most likely prudent (i.e. not worst case) levels of borrowing activity and was originally set at **£6.253m** and revised to **£2.987m** for the financial year.

8.4 Levels of debt are measured on an ongoing basis during the year for compliance with the Authorised Limit and the Operational Boundary. The Council maintained its total external borrowing and other long-term liabilities within both limits; at its peak this figure was:

	£K
Long Term Borrowing	44
Bank Overdraft	0
Other Long Term Liabilities (Finance Leases) (Maximum Outstanding)	2,146
Total	**2,190**

9. Adoption of the CIPFA Treasury Management Code (Prudential Indicator 8):

9.1 This indicator demonstrates that the Council has adopted the principles of best practice.

No. 8	**Adoption of the CIPFA Code of Practice in Treasury Management**
	The Council approved the adoption of the CIPFA Treasury Management Code at its Full Council meeting on 25th February 2003. The Council has incorporated any changes resulting from the CIPFA Treasury Management Code within its treasury policies, practices and procedures. At its meeting on 23 February 2010 the Council originally approved its Prudential Indicators for 2009/10. The Prudential Indicators were fully revised and approved by Council on 22nd February 2011 to reflect the results of the Capital Programme review.

10. Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure (Prudential Indicators 9 and 10):

10.1 These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The exposures are calculated on a gross basis. The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

No.	Interest Rate Exposures	2010/11 Original %	2010/11 Revised %	2010/11 Final Budget %	2010/11 Actual (during the financial year) %		
					Highest	Lowest	Average
	Fixed Interest Rates						
9	Upper Limit for Fixed Interest Rate Exposure	-100	-100	-100	-92	-51	-75
	Upper Limit for Fixed Interest Rate Exposure	100	100	100	100	100	100
	Net Fixed Exposure	**0**	**0**	**0**	**8**	**49**	**25**
	Variable Interest Rates						
10	Upper Limit for Variable Rate Exposure	-50	-75	-75	-49	-8	-25
	Upper Limit for Variable Interest Rate Exposure	30	30	30	0	0	0
	Net Variable Exposure	**-20**	**-45**	**-45**	**-49**	**-8**	**-25**

11. Maturity Structure of Fixed Rate borrowing (Prudential indicator 11):

11.1 This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

11.2 It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

No. 11	Maturity structure of fixed rate borrowing	Lower Limit %	Upper Limit %	Actual Borrowing as at 31.3.2011 £	Percentage of total as at 31.3.2011 %
	Under 12 months	0	100	5,000	13
	12 months and within 24 months	0	20	5,000	13
	24 months and within 5 years	0	80	30,000	74
	5 years and within 10 years	0	40	0	0
	10 years and within 20 years	0	60	0	0
	20 years and within 30 years	0	40	0	0
	30 years and within 40 years	0	40	0	0
	40 years and within 50 years	0	40	0	0
	50 years and above	0	20	0	0

11.3 The only long-term fixed rate borrowing the Council currently has is in relation to a brewery loan of **£0.040m**.

12. Upper Limit for total principal sums invested over 364 days (Prudential Indicator 12):

12.1 This indicator is set in order to allow the Council to manage the risk inherent in investments longer than 364 days. For 2010-11 this limit was originally set at £2.30m and later revised to **£2.50m**. At their peak, these investments totalled **£0m**.

13. Balanced Budget

13.1 The Council complied with the Balanced Budget requirement.

14. External Service Providers

14.1 Arlingclose is appointed as the Council's treasury management advisor. The Council is clear as to the services it expects and is provided under the contract. The service provision is comprehensively documented.

14.2 The Council is also clear that overall responsibility for treasury management remains with the Council.

15. Minimum Revenue Provision

15.1 The Council's MRP policy for 2010/11 was approved by Council on 23rd February 2010. It was determined that the Asset Life Option would be adopted for Unsupported Borrowing (i.e. Borrowing incurred without support from the Government through the Revenue Support Grant system).

APPENDIX G

Treasury Management Assurance

One of the key questions for Members in relation to Treasury Management is:

How can I be assured that agreed Treasury Management Strategies, Policies and Limits are being applied correctly within the Council ?

The answer to this question is provided by reviews that are undertaken by both independent internal and external bodies. The bodies and the type of review they undertake are shown below.

The Internal Audit Function

Internal Audit annually reviews the Treasury Management function due to the high level of risk attached to the activity. These reviews are either:

- A review of the high level controls of the Treasury Management System required by our External Auditors or;
- A full review of the Treasury Management System.

<u>The full review of the Treasury Management System – 2010/11</u>

Overall Audit Opinion – **Substantial Assurance**[6].

We are pleased to note that there are a number of good controls in operation:

- ✓ The Treasury Management Strategy has been approved by Cabinet;
- ✓ There are up to date documented Treasury Management Practices in place in line with the CIPFA Code of Practice on Treasury Management;
- ✓ Daily cash flow forecasts are completed;
- ✓ Investments are made in line with the limits defined in the strategy;
- ✓ Thorough consideration of the risks and the rate of return available is undertaken prior to an investment being made and there is adequate documentation to support the reasons for the decision;
- ✓ All investments and repayments tested could be traced to the council's bank accounts;
- ✓ All investments are appropriately authorised by one of the Financial Services Managers or the Senior Financial Services Manager;
- ✓ Interest due to the Council is calculated correctly and receipt of the interest is monitored;
- ✓ The records maintained of investments are accurate;
- ✓ Performance is reported to Cabinet and the Overview & Scrutiny Committee;
- ✓ Monthly Treasury Management Meetings are held where upcoming investment decisions are discussed; and
- ✓ There is a tested business continuity plan in place.

The areas for improvement are included in the action plan (there is one low risk action):

- No evidence could be located to prove that the authorised signatories for the NatWest Bank Account are up to date - *The implication is that the signatories list held by the bank could be out of date.* The Financial Services Manager has contacted the bank who confirmed that the authorised signatories for the bank accounts include two officers who have left the authority and a letter has been sent to the bank requesting that they are removed.

Our External Treasury Management Advisors

We seek feedback from Arlingclose Ltd when we review our Strategies, Practices, Processes or a system to ensure what we are proposing complies with Legal and Regulatory requirements and Best Practice. We have sought feedback this year in relation to the Treasury Management Strategy Report.

"Lichfield has a very tailored, understandable Treasury Strategy Statement. It is good to see any new issues or changes are highlighted to members in a clear manner, without jargon".