

Treasury Management Strategy Statement, Minimum Revenue Provision Strategy and Annual Investment Strategy 2012/13

Summary

This report presents the suggested Treasury Management, Minimum Revenue Provision and Annual Investment Strategies for 2012/13, including risk management, prudential indicators, the borrowing requirement and investment strategy. Background information on the economic situation and the likely interest rate movements are included in the report, which informs the recommendations made.

Portfolio Holder: Cllr R Standley, Leader of the Council

Recommendation

Cabinet is recommended to **recommend to Council** to:

- A. Approve the Treasury Management Strategy and Annual Investment Strategy as set out in this report;
- B. Approve the Specified and Non-specified Investments categories listed in Appendix D to this report;
- C. Set the Prudential and Treasury Indicators as set out in Appendix B to this report; and
- D. Approve that for the 2012/13 financial year the Council makes Minimum Revenue Provision in accordance with the Asset Life (Equal Instalment) Method for new capital expenditure.

Reason

The Council's Financial Procedure Rules require the Chief Finance Officer, in accordance with the CIPFA Code of Practice on Treasury Management, to report, at or before the start of each financial year, a proposed Treasury Management Strategy. The Local Government Act 2003 requires the Council to approve an Investment Strategy, Minimum Revenue Provision Strategy and certain Prudential Indicators for Treasury Management.

Introduction

1. The Local Government Act 2003 and supporting regulations requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

2. The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act - The CIPFA Treasury Management Code of Practice) which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.
3. The Department of Communities and Local Government has issued revised investment guidance which came into effect from 1 April 2010. There were no major changes required over and above the changes already required by the revised CIPFA Treasury Management Code of Practice 2009.

The Revised CIPFA Treasury Management Code of Practice 2009

4. The Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Services Code of Practice 2009 (the Code) was adopted by this Council on 17 February 2010.
5. The revised Code has emphasised a number of key areas including the following:
 - (a) All councils must formally adopt the revised Code and four clauses;
 - (b) The strategy report will affirm that the effective management and control of risk are prime objectives of the Council's treasury management activities;
 - (c) 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 that will be carried out;
 - (d) Responsibility for risk management and control lies within the organisation and cannot be delegated to any outside organisation;
 - (e) 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 the credit ratings of that government support;
 - (f) Councils need a sound diversification policy with high credit quality counterparties and should consider setting country, sector and group limits;
 - (g) Borrowing in advance of need is only to be permissible when there is a clear business case for doing so and only for the current capital programme or to finance future debt maturities;
 - (h) The main annual treasury management reports must be approved by Full Council;
 - (i) 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;

- (j) Each council must delegate the role of scrutiny of treasury management strategy and policies to a specific named body. In the case of this Council this is the Internal and Audit Scrutiny Committee;
- (k) Treasury management performance and policy setting should be subjected to prior scrutiny;
- (l) Members should be provided with access to relevant training;
- (m) Those charged with governance are also personally responsible for ensuring they have the necessary skills and training;
- (n) Responsibility for these activities must be clearly defined within the organisation; and
- (o) 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.

Treasury Management Strategy for 2012/13

6. The Local Government Act 2003 (the Act) 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 the Council's capital investment plans are affordable, prudent and sustainable.
7. The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act) this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.
8. The suggested strategy for 2012/13 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser, Sector Treasury Services.
9. The strategy covers:
 - (a) treasury limits in force which will limit the treasury risk and activities of the Council;
 - (b) Prudential and Treasury Indicators;
 - (c) the current treasury position;
 - (d) the borrowing requirement;
 - (e) prospects for interest rates;
 - (f) the borrowing strategy;
 - (g) policy on borrowing in advance of need;
 - (h) debt rescheduling;
 - (i) the investment strategy;

- (j) creditworthiness policy;
- (k) policy on use of external service providers; and
- (l) the Minimum Revenue Provision (MRP) strategy.

Balanced Budget Requirement

10. 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:
 - (a) Increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
 - (b) Any increases 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.

Housing Revenue Account Self Financing Debt Settlement

11. The requirement for the HRA Self Financing settlement to be made to the Department for Communities and Local Government on 28 March 2012 will require a separate consideration of a borrowing strategy. The Council will need to have the cash settlement amount of £48.3m available by the 28th March 2012, so separate borrowing solely for this purpose is anticipated. The PWLB are providing loans at interest rates 0.85% lower than the usual PWLB interest rates solely for the settlement requirements. This provides a compelling reason to utilise this borrowing availability. The exact structure of debt to be drawn is currently being considered by officers to ensure it meets the requirements of the HRA business plan and the overall requirements of the Council. This assessment cannot be made until final determinations are made by government in January 2012 and Council determines the final rent increase in February 2012. Once these are known and have been input into the Business Plan model and cash flow for debt repayment purposes has been established, the final loan date structures cannot be determined. Whilst the debt can be drawn earlier than needed, this may incur a revenue cost, and will be considered when a review of the structure of actual prevailing borrowing and investment interest rates is undertaken nearer to the time.
12. The borrowing strategy will be take loans with various maturities so that debt can be repaid throughout the 30 year life of the Business Plan. As debt is repaid this will add to the £11.3m headroom up to the £64.7m debt cap imposed by the Government.

Treasury Limits for 2012/13 to 2014/15

13. It is a statutory duty under Section 3 of the Act 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”. In England and Wales the Authorised Limit represents the legislative limit specified in the Act.
14. 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 and council rent levels is ‘acceptable’.
15. Whilst termed an “Affordable Borrowing Limit”, the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years, details of the Authorised Limit can be found in Appendix B of this report.

Current Portfolio Position

16. The Council’s treasury portfolio position at 31/12/2011 comprised:

Borrowing at 31/12/2011		
	Principal £(000)	Average Rate
Fixed Rate Borrowing		
Fixed Rate: Public Works Loans Board	5,553	6.23%
Total Borrowing	5,553	
Investments at 31/12/2011		
	Principal £(000)	Average Rate
Short term money market (in-house)	30,789	0.75%
Total Investments	30,789	
Net Investment	25,236	

Borrowing Requirement

17. The Council’s borrowing requirement is as follows:

Estimated Capital Borrowing Requirement				
	2011/12	2012/13	2013/14	2014/15
	£(000)	£(000)	£(000)	£(000)
Replacement of maturing debt	-	-	-	-
HRA Self Financing Settlement	48,300	-	-	-
Conversion of HRA Internal Borrowing	6,900	-	-	-
Capital Expenditure financed by loan	1,900	4,919	5,237	1,315
Capital Borrowing Requirement	57,100	4,919	5,327	1,315

Prudential and Treasury Indicators for 2012/13 – 2013/14

18. Prudential and Treasury Indicators as set out in Appendix B to this report are relevant for the purposes of setting an integrated treasury management strategy.
19. The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The revised Code was adopted on 17 February 2010.

Prospects for Interest Rates

20. The Council has appointed Sector Treasury Services as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates. Appendix A draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Sector central view.

Sector Bank Rate Forecast	
Financial Year	Bank Rate %
2010/11	0.50%
2011/12	1.00%
2012/13	2.25%
2013/14	3.25%

21. There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected. A detailed view of the current economic background is contained within Appendix C to this report.

Borrowing Strategy

Borrowing Rates

22. The Sector forecast for the Public Works Loans Board (PWLB) new borrowing rate is as follows:

	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Mar-13	Mar-14
Bank rate	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	2.25%	3.25%
5yr PWLB rate	3.00%	3.00%	3.10%	3.20%	3.30%	3.50%	4.40%	5.00%
10yr PWLB rate	4.10%	4.10%	4.10%	4.20%	4.30%	4.40%	5.00%	5.40%
25yr PWLB rate	5.00%	5.10%	5.20%	5.30%	5.30%	5.40%	5.50%	5.70%
50yr PWLB rate	5.10%	5.20%	5.30%	5.40%	5.40%	5.50%	5.60%	5.70%

Source: Sector Treasury Services

23. A more detailed Sector forecast is included in Appendix A.
24. The Council's borrowing strategy will give consideration to new borrowing in the following order of priority:
 - (a) The cheapest borrowing will be internal borrowing by running down cash balances and foregoing interest earned at historically low rates. However, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing the short term advantage of internal borrowing against potential long term costs if the opportunity is missed for taking market loans at long term rates which will be higher in future years;
 - (b) PWLB variable rate loans for up to 10 years;
 - (c) Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintaining an appropriate balance between PWLB and market debt in the debt portfolio;
 - (d) PWLB borrowing for periods under 10 years where rates are expected to be significantly lower than rates for longer periods. This offers a range of options for new borrowing which will spread debt maturities away from a concentration in longer dated debt;
 - (e) Preference will be given to PWLB borrowing by annuity and EIP loans instead of to maturity loans.

Sensitivity of the forecast

25. In normal circumstances the main sensitivities of the forecast are likely to be the two scenarios noted below. Officers, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:
 - (a) If it were felt that there was a significant risk of a sharp FALL in long and short term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered; or
 - (b) If it were felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

External v Internal Borrowing

26. The revised Prudential Code paragraph 43 now requires each authority to explain its policy on gross and net debt if there is a significant difference between them.

Comparison of Gross and Net Debt Position

	2010/11	2011/12	2012/13	2013/14	2014/15
	£(000)	£(000)	£(000)	£(000)	£(000)
Gross External Debt	(6,533)	(61,753)	(60,732)	(61,903)	(60,943)
Cash Balances	7,380	10,000	7,335	5,154	5,000
Net Investment/(Debt)	847	(51,573)	(53,397)	(56,758)	(55,943)

27. This Council currently has a net debt (after deducting cash balances) forecast at 31 March of 2012, of £51.573 million.
28. The general aim of this treasury management strategy is to reduce the difference between the two debt levels over the next three years in order to reduce the credit risk incurred by holding investments. However, measures taken in the last year have already reduced substantially the level of credit risk so another factor which will be carefully considered is the difference between borrowing rates and investment rates to ensure the Council obtains value for money.
29. The next financial year is expected to again be one of historically abnormally low Bank Rate. This provides a continuation of the current window of opportunity for local authorities to fundamentally review their strategy of undertaking new external borrowing.
30. Over the next three years, investment rates are therefore expected to be below long term borrowing rates and so value for money considerations would indicate that value could best be obtained by avoiding new external borrowing and by using internal cash balances to finance new capital expenditure or to replace maturing external debt (this is referred to as internal borrowing). This would maximise short term savings.
31. However, short term savings by avoiding new long term external borrowing in 2012/13 will also be weighed against the potential for incurring additional long term extra costs by delaying unavoidable new external borrowing until later years when PWLB long term rates are forecast to be significantly higher.
32. The Council has examined the potential for undertaking early repayment of some external debt to the PWLB in order to reduce the difference between its gross and net debt positions. However, the introduction by the PWLB of significantly lower repayment rates than new borrowing rates in November 2007, which has now been compounded since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has meant that large premiums would be incurred by such action and would also do so in the near term; such levels of premiums cannot be justified on value for money grounds. This situation will be monitored in case these differentials are narrowed by the PWLB at some future date.
33. The proposal to move to a single site headquarters at Hailsham will require considerable capital investment. It is proposed to utilise internal borrowing

to finance this project as, in the current market conditions, this represents better value for money than undertaking external borrowing.

34. Against this background caution will be adopted with the 2012/13 treasury operations. The Chief Finance Officer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to Cabinet at the next available opportunity.

Policy on borrowing in advance of need

35. 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.
36. In determining whether borrowing will be undertaken in advance of need the Council will:
 - (a) 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;
 - (b) ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered;
 - (c) evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;
 - (d) consider the merits and demerits of alternative forms of funding;
 - (e) consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use; and
 - (f) consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

Debt Rescheduling

37. The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt, which has now been compounded since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has meant that PWLB to PWLB debt restructuring is now much less attractive than it was before both of these events. In particular, consideration would have to be given to the large premiums which would be incurred by prematurely repaying existing PWLB loans and it is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing. However, some interest savings might still be achievable through using LOBO (Lenders Option Borrowers Option) loans, and other

market loans, in rescheduling exercises rather than using PWLB borrowing as the source of replacement financing.

38. As short term borrowing rates will be considerably cheaper than longer term rates, there are likely to be significant opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of their short term nature and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio. Any such rescheduling and repayment of debt is likely to cause a flattening of the Council's maturity profile as in recent years there has been a skew towards longer dated PWLB.
39. 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 paid on current debt.
40. The reasons for any rescheduling to take place will include:
 - (a) the generation of cash savings and / or discounted cash flow savings;
 - (b) helping to fulfil the strategy outlined above; and
 - (c) enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).
41. Consideration will also be given to identify if there is any residual potential left 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 paid on current debt.
42. All rescheduling will be discussed with the Portfolio Holder for Finance and reported to the Cabinet, at the earliest meeting following its action.

Annual Investment Strategy

Investment Policy

43. The Council will have regard to the DCLG's Guidance on Local Government Investments ("the Guidance") and the 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are, in order of importance:
 - (a) the security of capital; and
 - (b) the liquidity of its investments.
44. The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investments.
45. The borrowing of monies purely to invest or on lend and make a return is unlawful and this Council will not engage in such activity.
46. Investment instruments identified for use in the financial year are listed in Appendix D under the 'Specified' and 'Non-Specified' Investments

categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules but are generally no more than £4 million with any institution and also a country limit (excluding the UK) of £3 million.

Creditworthiness policy

47. This Council uses the creditworthiness service provided by Sector Treasury Services. This service has been progressively enhanced over the last year and now uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:
 - (a) credit watches and credit outlooks from credit rating agencies;
 - (b) Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings; and
 - (c) sovereign ratings to select counterparties from only the most creditworthy countries.
48. This modelling approach combines credit ratings, credit watches, credit outlooks and CDS spreads in a weighted scoring system for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments and are therefore referred to as durational bands. The Council is satisfied that this service now gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.
49. The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Sector's weekly credit list of worldwide potential counterparties. The Council will therefore use counterparties within the following durational bands:
 - (a) Yellow 5 years
 - (b) Purple 2 years
 - (c) Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
 - (d) Orange 1 year
 - (e) Red 6 months
 - (f) Green 3 months
 - (g) No Colour not to be used.
50. This Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties as Moodys are currently very much more aggressive in giving low ratings than the other two agencies. This would therefore be unworkable and leave the Council with few banks on its approved lending

list. The Sector creditworthiness service does though, use ratings from all three agencies, but by using a scoring system, does not give undue preponderance to just one agency's ratings.

51. All credit ratings will be monitored daily. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.
52. If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
53. In addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list.
54. Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and information, information on government support for banks and the credit ratings of that government support.

Country Limits

55. The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AAA from Fitch Ratings (or equivalent from other agencies if Fitch does not provide) The list of countries that qualify using this credit criteria as at the date of this report are shown in appendix E. This list will be added to or deducted from by officers should ratings change in accordance with this policy. The Council has also set a maximum amount of £3 million in any country outside the UK.

Investment Strategy - In-house managed funds

56. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).
57. The Council will seek to utilise its business reserve accounts and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.
58. For 2012/13 it is suggested that the Council should budget for an investment return of 0.70% on investments placed during the financial year and this has been fed into budget forecasts.
59. Prospects for Bank Rates and investment returns are summarised in the table below.

Financial Year	Bank Rate	Investment Return
2012/13	0.50%	0.70%
2013/14	0.50%	1.00%
2014/15	1.25%	1.60%
2015/16	2.50%	3.30%
2016/17	3.50%	4.10%

End of year investment report

60. At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report to full Council.

Policy on the use of external service providers

61. The Council uses Sector Treasury Services as its external treasury management advisers.
62. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. Council officers are clear between what constitutes and information and what constitutes advice.
63. The Council also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

Scheme of Delegation

64. Council has approved a Scheme of Delegation. This is attached as Appendix F.

Role of the Section 151 Officer

65. The Council has approved the role of the Section 151 Officer (Chief Finance Officer) in relation to treasury management. This is attached as Appendix G.

Minimum Revenue Provision Strategy

66. Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. It would be impractical to charge the entirety of such expenditure to revenue in the year in which it was incurred therefore such expenditure is spread over several years in order to try to match the years over which such assets benefit the local community through their useful life. The manner of spreading these costs is through an annual Minimum Revenue Provision, which was previously determined under Regulation, and will in future be determined under Guidance.

67. Statutory Instrument 2008 no. 414 s4 lays down that a local authority shall determine for the current financial year an amount of minimum revenue provision that it considers to be prudent. There is no requirement to charge MRP where the Capital Financing Requirement (CFR) is nil or negative at the end of the preceding financial year. The share of Housing Revenue Account Capital Financing Requirement is not subject to a statutory MRP charge.

Government Guidance

68. Along with the above duty, the Government issued guidance which came into force on 31st March 2008 which requires that a Statement on the Council's policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which the provision will relate.
69. The Council is legally obliged to "have regard" to the guidance, which is intended to enable a more flexible approach to assessing the amount of annual provision than was required under the previous statutory requirements. The guidance offers four main options under which MRP could be made, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. The requirement to 'have regard' to the guidance therefore means that:
- (a) Although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent; and
 - (b) It is the responsibility of each authority to decide upon the most appropriate method of making a prudent provision, after having had regard to the guidance.

Option 1: Regulatory Method

70. Under the previous MRP regulations, MRP was set at a uniform rate of 4% of the adjusted CFR (i.e. adjusted for "Adjustment A" in relation to the Housing Revenue Account to ensure consistency with previous Regulations) on a reducing balance method (which in effect meant that MRP charges would stretch into infinity). This historic approach must continue for all capital expenditure incurred in years before the start of this new approach. It may also be used for new capital expenditure up to the amount which is deemed to be supported through the SCE annual allocation.

Option 2: Capital Financing Requirement Method

71. This is a variation on option 1 which is based upon a charge of 4% of the aggregate CFR without any adjustment for Adjustment A, or certain other factors which were brought into account under the previous statutory MRP

calculation. The CFR is the measure of an authority's outstanding debt liability as depicted by their balance sheet.

Option 3: Asset Life Method

72. This method may be applied to most new capital expenditure, including where desired that which may alternatively continue to be treated under options 1 or 2.
73. Under this option, it is intended that MRP should be spread over the estimated useful life of either an asset created, or other purpose of the expenditure. There are two useful advantages of this option:
 - (a) Longer life assets e.g. freehold land can be charged over a longer period than would arise under options 1 and 2; and
 - (b) No MRP charges need to be made until the financial year after that in which an item of capital expenditure is fully incurred and, in the case of a new asset, comes into service use (this is often referred to as being an 'MRP holiday'). This is not available under options 1 and 2.
74. There are two methods of calculating charges under option 3:
 - (a) equal instalment method – equal annual instalments; or
 - (b) annuity method – annual payments gradually increase during the life of the asset.

Option 4: Depreciation Method

75. Under this option, MRP charges are to be linked to the useful life of each type of asset using the standard accounting rules for depreciation (but with some exceptions) i.e. this is a more complex approach than option 3. The same conditions apply regarding the date of completion of the new expenditure as apply under option 3.

Strategy

76. The Council continues to use the Regulatory Method for all capital expenditure incurred up to 2007/08.
77. The Council has evaluated the options and considers that the Asset Life - Equal Instalment Method is the most appropriate for it to use.

Minimum Revenue Provision Policy Statement 2012/13

78. The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2008/09, and will assess MRP for 2012/13 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.
79. The major proportion of the MRP for 2012/13 will relate to the more historic debt liability that will continue to be charged at the rate of 4%, in accordance with the Regulatory Method option of the guidance. Certain expenditure reflected within the debt liability at 31st March 2012 will be subject to MRP

under the Asset Life - Equal Instalment Method option, which will be charged over a period which is reasonably commensurate with the estimated useful life applicable to the nature of expenditure, using the equal annual instalment. For example, capital expenditure on a new building, or on the refurbishment or enhancement of a building, will be related to the estimated life of that building.

80. Estimated life periods will be determined by the Chief Finance Officer. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.
81. As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

Corporate Management Team Advice

82. Cabinet is recommended **to recommend to Council**:
 - (a) Approve the Treasury Management Strategy and Annual Investment Strategy as set out in this report;
 - (b) Approve the Specified and Non-specified Investments categories listed in Appendix D to this report;
 - (c) Set the Prudential and Treasury Indicators as set out in Appendix B to this report; and
 - (d) Approve that for the 2012/13 financial year the Council makes Minimum Revenue Provision in accordance with the Asset Life (Equal Instalment) Method for new capital expenditure.

Financial Implications

83. The strategy proposed in this report, together with the interest rates forecast, are in line with the assumptions made when the 2012/13 budget was prepared. The costs of treasury operations, debt management expenses and investment income are included in the 2012/13 budget.

Legal Implications

84. The Local Government Act 2003 and supporting regulations requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. The Council has

also has to 'have regard' to the DCLG's Guidance on Local Government Investments ("the Guidance") issued in April 2010 and CIPFA's Revised Treasury Management in Public Services Code of Practice 2009 and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

Human Resources Implications

85. None arising directly from this report.

Other Implications

86. The Treasury Strategy has been formulated to minimise risk. Credit ratings and other market intelligence are used and counterparty limits also assist to assess and mitigate risk. The adoption of the revised CIPFA Treasury Management Code also embeds risk management further into treasury management operations.

Other Implications	Applies?	Other Implications	Applies?
Human Rights	No	Equalities and Diversity	No
Crime and Disorder	No	Consultation	No
Environmental	No	Access to Information	No
Sustainability	No	Exempt from publication	No
Risk Management	Yes		

Director:	Nigel Hannam, Director of Corporate Services		
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Appendices:	A	Interest Rate Forecasts	
	B	Prudential and Treasury Indicators	
	C	Economic background	
	D	Specified and Non-specified Investments	
	E	Approved countries for investment	
	F	Treasury Management Scheme of Delegation	
	G	Treasury Management Role of the Section 151 Officer	
Background Papers:	Working papers held by Financial Services CIPFA Revised Treasury Management Code of Practice 2009		

Appendix A Interest Rate Forecasts

Interest Rate Forecasts

The data below shows a variety of forecasts published by a number of institutions. The forecast within this strategy statement has been drawn from these diverse sources and officers' own views.

Sector's Interest Rate View															
	Now	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Sector's Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	2.00%	2.25%	2.50%
3 Month LIBID	0.87%	0.70%	0.70%	0.70%	0.70%	0.70%	0.75%	0.80%	0.90%	1.20%	1.40%	1.60%	2.10%	2.40%	2.60%
6 Month LIBID	1.16%	1.00%	1.00%	1.00%	1.00%	1.00%	1.10%	1.20%	1.40%	1.60%	1.80%	2.00%	2.50%	2.70%	2.90%
12 Month LIBID	1.65%	1.50%	1.50%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.20%	2.40%	2.60%	3.10%	3.20%	3.30%
5yr PWLB Rate	2.25%	2.30%	2.30%	2.30%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.10%	3.30%	3.50%	3.70%
10yr PWLB Rate	3.33%	3.30%	3.30%	3.30%	3.40%	3.40%	3.50%	3.60%	3.70%	3.80%	4.00%	4.20%	4.40%	4.60%	4.80%
25yr PWLB Rate	4.24%	4.20%	4.20%	4.20%	4.30%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%
50yr PWLB Rate	4.26%	4.30%	4.30%	4.30%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.30%
Bank Rate															
Sector's View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	2.00%	2.25%	2.50%
UBS	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	-	-	-	-	-	-	-	-	-
Capital Economics	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	-	-	-	-	-
5yr PWLB Rate															
Sector's View	2.25%	2.30%	2.30%	2.30%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.10%	3.30%	3.50%	3.70%
UBS	2.25%	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital Economics	2.25%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	-	-	-	-	-
10yr PWLB Rate															
Sector's View	3.33%	3.30%	3.30%	3.30%	3.40%	3.40%	3.50%	3.60%	3.70%	3.80%	4.00%	4.20%	4.40%	4.60%	4.80%
UBS	3.33%	3.45%	3.45%	3.50%	3.60%	3.65%	-	-	-	-	-	-	-	-	-
Capital Economics	3.33%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	-	-	-	-	-
25yr PWLB Rate															
Sector's View	4.24%	4.20%	4.20%	4.20%	4.30%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%
UBS	4.24%	4.80%	4.90%	4.90%	4.90%	4.90%	-	-	-	-	-	-	-	-	-
Capital Economics	4.24%	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	-	-	-	-	-
50yr PWLB Rate															
Sector's View	4.26%	4.30%	4.30%	4.30%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.30%
UBS	4.26%	4.80%	4.95%	4.95%	5.00%	5.00%	-	-	-	-	-	-	-	-	-
Capital Economics	4.26%	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	-	-	-	-	-

Appendix B
Prudential and Treasury Indicators

Prudential and Treasury Indicators

PRUDENTIAL INDICATORS	2010/11	2011/12	2012/13	2013/14	2014/15
	Actual	probable outturn	estimate	estimate	estimate
	£'000	£'000	£'000	£'000	£'000
Capital Expenditure					
Non - HRA	3,330	8,251	4,721	6,352	1,210
HRA	2,540	4,073	6,641	7,533	8,278
TOTAL	5,870	12,324	11,362	13,885	9,488
Ratio of financing costs to net revenue stream					
Non - HRA	4.78%	3.31%	4.67%	4.29%	3.68%
HRA	26.68%	24.54%	35.21%	23.18%	22.77%
Net Debt Position at 31 March					
Non-HRA	4,736	7,952	4,454	2,264	2,119
HRA	(3,889)	(59,525)	(57,851)	(59,022)	(58,062)
TOTAL	847	(51,573)	(53,397)	(56,758)	(55,943)
Capital Financing Requirement as at 31 March					
Non – HRA	3,592	4,783	8,772	9,093	8,444
HRA 0	12,300	59,542	60,445	62,688	65,554
TOTAL	15,892	64,325	69,217	71,761	73,998
Maximum HRA Capital Financing Requirement	N/A	71,679	71,679	71,679	71,679
Annual change in Cap. Financing Requirement					
Non – HRA	1,359	1,191	3,989	321	-649
HRA	196	49,242	903	2,243	2,866
TOTAL	1,555	50,443	4,892	2,564	2,217
Incremental impact of capital investment decisions					
Increase in council tax (band D) per annum	£9.29	-£1.12	£13.72	£75.25	£19.04
Increase in average housing rent per week	-£5.53	£1.71	£21.71	£19.46	£55.60

Appendix B
Prudential and Treasury Indicators

TREASURY MANAGEMENT INDICATORS	2010/11	2011/12	2012/13	2013/14	2014/15
	actual	probable outturn	estimate	estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt -					
Borrowing	25,000	200,000	200,000	200,000	200,000
other long term liabilities (finance leases)	100	10,000	20,000	10,000	10,000
TOTAL	25,100	210,000	220,000	210,000	210,000
Operational Boundary for external debt -					
Borrowing	15,000	100,000	100,000	100,000	100,000
other long term liabilities (finance leases)	5,000	7,000	10,000	5,000	5,000
TOTAL	20,000	107,000	110,000	105,000	105,000
Actual external debt	6,553	61,753	60,732	61,903	60,943
Upper limit for fixed interest rate exposure					
Net principal re fixed rate borrowing / investments:-	100%	100%	100%	100%	100%
Upper limit for variable rate exposure					
Net principal re variable rate borrowing / investments:-	0%	50%	50%	50%	50%
Upper limit for total principal sums invested for over 364 days					
(per maturity date)	8,000	8,000	8,000	8,000	8,000

Maturity structure of fixed rate borrowing during 2012/13	upper limit	lower limit
under 12 months	25%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	75%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

Economic Background

Global Economy

1. The outlook for the global economy remains clouded with uncertainty with the UK economy struggling to generate sustained recovery that offers any optimism for the outlooks for 2011 and 2012, or possibly even into 2013. Consumer and business confidence levels are low and with little to boost sentiment, it is not easy to see potential for a significant increase in the growth rate in the short term.
2. At the centre of much of the uncertainty is the ongoing Eurozone sovereign debt crisis which has intensified, rather than dissipated throughout 2011. The main problem has been Greece, where, even with an Eurozone/IMF/ECB bailout package and the imposition of austerity measures aimed at deficit reduction, the lack of progress and the ongoing deficiency in addressing the underlying lack of competitiveness of the Greek economy, has seen an escalation of their problems. These look certain to result in a default of some kind but it currently remains unresolved if this will be either “orderly” or “disorderly”, and/or also include exit from the €uro bloc.
3. As if that were not enough there is growing concern about the situation in Italy and the risk that contagion has not been contained. Italy is the third biggest debtor country in the world but its prospects are limited given the poor rate of economic growth over the last decade and the lack of political will to address the need for fundamental reforms in the economy. The Eurozone now has a well established track record of always doing too little too late to deal with this crisis; this augurs poorly for future prospects, especially given the rising level of electoral opposition in northern EU countries to bailing out profligate southern countries.
4. The US economy offers little to lift spirits. With the next Presidential elections due in November 2012, the current administration has been hamstrung by political gridlock with the two houses split between the main parties. In quarter 3 the Federal Reserve started “Operation Twist” in an effort to re-ignite the economy in which growth is stalling. High levels of consumer indebtedness, unemployment and a moribund housing market are weighing heavily on consumer confidence and so on the ability to generate sustained economic growth.
5. Hopes for broad based recovery have, therefore, focussed on the emerging markets but these areas have been struggling with inflationary pressures in their previously fast growth economies. China, though, has maintained its growth pattern, despite tightening monetary policy to suppress inflationary pressures, but some forward looking indicators are causing concern that there may not be a soft landing ahead, which would then be a further dampener on world economic growth..

Appendix C Economic Background

UK Economy

6. The Government's austerity measures, aimed at getting the public sector deficit into order over the next four years, have yet to fully impact on the economy. However, coming at a time when economic growth has virtually flatlined and concerns at the risk of a technical recession (two quarters of negative growth) in 2012, it looks likely that the private sector will not make up for the negative impact of these austerity measures given the lack of an export led recovery due to the downturn in our major trading partner – the EU. The housing market, a gauge of consumer confidence, remains weak and the outlook is for house prices to be little changed for a prolonged period.

Economic growth

7. GDP growth has, basically, flatlined since the election of 2010 and, worryingly, the economic forecasts for 2011 and 2012 have been revised lower on a near quarterly basis as the UK recovery has, effectively, stalled. With fears of a potential return to recession the Bank of England embarked on a second round of Quantitative Easing to stimulate economic activity.

Unemployment

8. With the impact of the Government's austerity strategy impacting the trend for 2011 of steadily increasing unemployment, there are limited prospects for any improvement in 2012 given the deterioration of growth prospects.

Inflation and Bank Rate

9. For the last two years, the MPC's contention has been that high inflation was the outcome of temporary external factors and other one offs (e.g. changes in VAT); that view remains in place with CPI inflation standing at 5.2% at the start of quarter 4 2011. They remain of the view that the rate will fall back to, or below, the 2% target level within the two year horizon.

UK Sovereign Rating

10. The ratings agencies have recently reaffirmed the UK's AAA sovereign rating and have expressed satisfaction with Government policy at deficit reduction. They have, though, warned that this could be reviewed if the policy were to change, or was seen to be failing to achieve its desired outcome. This credit position has ensured that the UK government is able to fund itself at historically low levels and with the safe haven status from Eurozone debt also drawing in external investment the pressure on rates has been down, and looks set to remain so for some time.

Sector View

11. It is currently difficult to have confidence as to exactly how strong the UK Economic forecasting remains troublesome with so many external influences weighing on the UK. There does, however, appear to be consensus among analysts that the economy remains weak and whilst there

Appendix C

Economic Background

is still a broad range of views as to potential performance, they have all been downgraded throughout 2011. Key areas of uncertainty include:

- (a) a worsening of the Eurozone debt crisis and heightened risk of the breakdown of the bloc or even of the currency itself;
 - (b) the impact of the Eurozone crisis on financial markets and the banking sector;
 - (c) the impact of the Government's austerity plan on confidence and growth and the need to rebalance the economy from services to exporting manufactured goods;
 - (d) the under-performance of the UK economy which could undermine the Government's policies that have been based upon levels of growth that increasingly seem likely to be undershot;
 - (e) a continuation of high levels of inflation ;
 - (f) the economic performance of the UK's trading partners, in particular the EU and US, with some analysts suggesting that recession could return to both;
 - (g) stimulus packages failing to stimulate growth;
 - (h) elections due in the US, Germany and France in 2012 or 2013; and
 - (i) potential for protectionism i.e. an escalation of the currency war / trade dispute between the US and China.
12. The overall balance of risks remains weighted to the downside. Lack of economic growth, both domestically and overseas, will impact on confidence putting upward pressure on unemployment. It will also further knock levels of demand which will bring the threat of recession back into focus.
13. Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries.
14. Given the weak outlook for economic growth, Sector sees the prospects for any interest rate changes before mid-2013 as very limited. There is potential for the start of Bank Rate increases to be even further delayed if growth disappoints.

Appendix D
Specified and Non-specified investments

Specified investments			
Instrument	Minimum 'High' Credit Criteria	Use	Limits
Debt Management Agency Deposit Facility	--	In-house	Unlimited
Term deposits – UK government	--	In-house	£12 million
Term deposits – other UK Local Authorities	--	In-house	£4 million per counter party
Term deposits – UK banks and building societies	Short-term F1, Individual A or B, Support 1,2,3	In-house	£4 million per counter party
Term Deposits - UK banks where HM Government own more than 50% of the shares or have given banking support	Short-term F1	In-house	£4 million per counter party
Term Deposits - banks nationalised by high credit rated countries	Sovereign Rating AAA, Short term F1, Individual A or B, Support 1, 2	In-house	£3 million per country
Term Deposits - banks and building societies with government guarantee on ALL deposits by high credit rated countries	Sovereign Rating AAA, Short term F1, Individual A or B, Support 1, 2	In-house	£3 million per country
Money Market Funds	AAA	In-house	£4 million per Fund
Bonds issued by multilateral development banks	AAA	In-house on a 'buy-and-hold' to maturity basis after consultation / advice from the Council's Treasury Advisers	£3 million
Bonds issued by a financial institution which is guaranteed by the UK government	AAA	In-house on a 'buy-and-hold' to maturity basis after consultation / advice from the Council's Treasury Advisers	£4 million

All investments will be denominated in Sterling and any payments or repayments in respect of the investment will be payable only in Sterling. All investments will not be long-term investments (i.e. the investment is repayable within 12 months).

Appendix D
Specified and Non-specified investments

Non-specified investments				
Instrument	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period
Term deposits – UK government with maturities between 1 and 2 years		In-house	Up to £2 million with any one institution	2 years
Term deposits – other UK Local Authorities with maturities between 1 and 2 years		In-house	Up to £2 million with any one institution	2 years
Term deposits – UK banks and building societies with maturities between 1 and 2 years	Short-term F1, Individual A or B, Support 1,2,3	In-house	Up to £2 million with any one institution	2 years
Term deposits –banks and building societies nationalised by high credit rated countries with maturities between 1 and 2 years	Sovereign Rating AAA, Short term F1, Individual A or B, Support 1, 2	In-house	Up to £1 million with any one institution and country limit of £3 million	2 years
Term deposits –banks and building societies with maturities between 1 and 2 years with government guarantee on ALL deposits by high credit rated countries	Sovereign Rating AAA, Short term F1, Individual A or B, Support 1, 2	In-house	Up to £1 million with any one institution and country limit of £3 million	2 years
Term deposits with unrated UK counterparties : any maturity	Parent company must be rated. Short Term F1, Individual A or B, Support 1, 2 or 3. Unconditional guarantee must be given by parent. Unconditional guarantee by UK Government Subsidiaries of Scottish Clearing Banks	In-house	Up to £2 million with any one institution	1 year
		In-house	Up to £2 million with any one institution	1 year
		In-house	Up to £2 million with any one institution	1 year

Appendix E
Approved Countries for investment

Approved countries for investment

AAA Sovereign Rating

Australia
Canada
Denmark
Norway
Singapore
Sweden
Switzerland
U.K.

The following countries are on negative rating watch and will not be used until the Eurozone crisis has been resolved and their AAA rating affirmed:

Finland
France
Germany
Luxembourg
Netherlands

Appendix F
Treasury Management Scheme of Delegation

Treasury Management Scheme of Delegation

Full Council

1. Receiving and reviewing reports on treasury management policies, practices and activities.
2. Approval of annual strategy.
3. Budget consideration and approval.
4. Approval of the division of responsibilities.

Cabinet

1. Approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices.
2. Budget consideration and recommendation.
3. Receiving and reviewing regular monitoring reports and acting on recommendations.

Internal and Audit Scrutiny Committee

1. Reviewing the treasury management policy and procedures and making recommendations to the responsible body.

Treasury Management Role of the Section 151 Officer

Treasury Management Role of the Section 151 Officer

1. Recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance.
2. Submitting regular treasury management policy reports.
3. Submitting budgets and budget variations.
4. Receiving and reviewing management information reports.
5. Reviewing the performance of the treasury management function.
6. Ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function.
7. Ensuring the adequacy of internal audit, and liaising with external audit.
8. Recommending the appointment of external service providers.