AGENDA ITEM NO. 6(02)

POLICY AND RESOURCES SCRUTINY COMMITTEE – 2ND MARCH 2010

SUBJECT: TREASURY MANAGEMENT AND CAPITAL FINANCING PRUDENTIAL INDICATORS MONITORING REPORT – 3RD QUARTER 2009/10

REPORT BY: DIRECTOR OF CORPORATE SERVICES

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1. PURPOSE OF REPORT

1.1 To present Members with details of Treasury Management activities and Capital Financing, together with the related Prudential Indicators for the period 1st December 2009 to 31st January 2010.

1.2 To review the Treasury Management Strategy for 2009/2010 as set out in the Annual Investment Strategy and Capital Financing Prudential Indicators Report.

2. SUMMARY

2.1 The Code of Practice on Treasury Management in the Public Services, which was adopted by the Council on 4th March 2004, sets out a framework of operating procedures, which is encompassed in the Treasury Management Practices (TMPs). The Council subsequently approved the detailed TMPs on 27th May 2004. TMP6 (Reporting Requirements and Management Information Arrangements) provides for the submission of monitoring reports to the appropriate committee on a quarterly basis.

2.2 Under the provisions of the Local Government Act 2003, The Local Authorities (Capital Finance and Accounting)(Wales) Regulations 2003 [The Capital Regulations], and the CIPFA's " The Prudential Code for Capital Finance in Local Authorities" [the Code], the Authority is obliged to approve and publish a number of indicators relevant to Capital Finance and Treasury Management.

2.3 The Authority's Annual Investment Strategy and Capital Financing Prudential Indicators for 2009/10 were approved by Council on 26th February 2009.

3. LINKS TO STRATEGY

3.1 The report has links to the four basic strategic themes of the Council, taking into account cross-cutting issues where relevant. It has specific links to the effective and efficient application and use of resources.

4. THE REPORT

4.1 **Treasury Management**

4.1 Borrowing

4.2 Loans administered by Caerphilly CBC

Due to the level of interest rates predicted to be prevalent throughout 2009/10, in particular the difference between long-term borrowing rates and short-term investment rates, it is clearly more advantageous to use internal funding in lieu of borrowing. Therefore the decision was taken, as part of the approved strategy, that no new borrowing would be undertaken in the current year, either to replace maturing debt or to fund the capital programme.

During the period covered by this report, PWLB loans to the value of £259k. were repaid on maturity.

The portfolio's variable interest rate proportion at 31st January 2010 stood at 18.69%, which is within the Council's determination of 50%.

4.3 Rescheduling

The Annual Strategy provides for the utilisation of debt rescheduling to provide both in year and future year savings and additional revenue resources. No rescheduling opportunities presented themselves during the period covered by this report.

4.4 Loans administered by Newport City Council

These are non-PWLB loans held by the former Gwent County Council and administered by Newport City Council, which continue on a reducing basis until 2013/2014.

At the start of the financial year the amount outstanding relating to Caerphilly CBC was £332k. Repayments totalling £62k were made during the period covered by this report.

4.5 Investments

4.6 Long-term Investments

The Council no longer holds any long-term investments. The final investments totalling £10m were repaid on 8th December 2009.

4.7 Short-term Investments(Deposits) – up to 364 Days

The value of short-term deposits at 31st January 2010 was £78.140m and is made up of a spread of periods from instant access call accounts to 364 days. The average rate as at 31st January 2010 for these deposits was 0.29%, which compares unfavourably with the target rate, as detailed in the Annual Strategy 2009/10 report to Council on 26/02/09, of 1.00%.

It should be noted that the average rate reflects the fact that almost 50% (£38.78m) of the current portfolio is deposited with the Debt Management Office at rates averaging 0.25%.

On the basis of the current levels of interest rates and available balances, it is predicted that the overall rate that will be achieved for 2009/10 will be around 0.66%.

4.8 Strategy

In the previous quarter's report (Appendix 1) presented to this Committee on 19/01/10, Members were appraised of the further enhancements that Sector had made to their Creditworthiness reporting procedures which became operative from December 2009.

In the same report, Members were informed that the UK Credit Default Swap level was some 20 points over the benchmark. Current (as at 29/01/10) data shows that the UK CDS level of 81.975 has now fallen below the benchmark level of 88.62. However, there is still some speculation/suggestion that the UK AAA rating could be at risk due to the amount of outstanding debt and subsequently the UK continues to be on Negative Outlook (since May 2009).

Clearly, the Council's current risk averse strategy of only placing deposits with the UK Government could now been seen as more risky than previously. As a result, and in the light of the emphasis of the new CIPFA Treasury Management Code of Practice on managing risk, and in particular the need for diversification to spread the risks, there is a need to consider changes to the strategy which would involve moving a substantial part of the deposits held in the DMO into other institutions based on their creditworthiness. The main areas for consideration would include Money Market Funds, banks meeting the highest practical credit rating (including the Sovereign rating of the country) and multi-lateral development banks (e.g. European Investment Bank – AAA rated)

4.9 Sector Treasury Services

Members' views were previously sought with regard to the contract currently in place with Sector for the provision of Treasury Management advice.

Procurement processes have been implemented and it is intended that tender presentations will take place in early March in order to have the new service in place from 1st April 2010. .

4.10 Icelandic Banks

Members are reminded that, to date, some £2.9m has been received in respect of Heritable Bank. This sum represents dividends totalling some 28.79% of the total amount outstanding from Heritable of £10,097,065.89. A further unscheduled dividend is likely to be paid in March 2010, but no details of the sum involved are available at the time of writing.

Members are reminded that the Winding-up Board of Landsbanki has made a decision to afford priority status to local authority deposits. This, however, is subject to legal challenge as expected. The Local Government Association legal advisors Bevan Brittan are still confident that there is a strong case to determine that Local Authority deposits will rank as preferential creditors.

4.11 CIPFA Treasury Management Code of Practice - Revision

The new Code of Practice, and associated guidance notes, have now been published and officers are reviewing operating procedures in light of the new guidance. A brief overview of the changes to the Code were detailed in Appendix 7 of the previous report to this Committee.

In addition to the new TM Code, CIPFA has also more recently issued a revision to the Prudential Code. The Welsh Assembly Government is currently consulting on changes to its Investment Guidance. Officers will report on the implications/content of both documents at a later date.

5. PRUDENTIAL INDICATORS

5.1 Capital Financing Requirement

The capital financing requirement measures the authority's underlying need to borrow for a capital purpose. In accordance with best professional practice, the authority does not associate borrowing with particular items or types of expenditure. In practice, the raising and repaying of loans is determined primarily by professional / expert advice, and may not necessarily take place in the relevant year. In order to create an operating environment within which the Treasury Manager can legitimately react to appropriate advice, the various authorised limits as identified in ***Appendix 1*** are set at a level in excess of the capital financing requirement.
In the financial year to date, the authority has been operating within the approved limits.

As a result of the introduction of the International Financial Reporting Standard for the year ending 31/3/11 (which has impacts upon the year ending 31/3/10) the Authority will need to change the treatment of Private Finance Initiative assets (PFI). These changes will impact upon the Capital Financing figures and the Minimum Revenue Provision policy that is currently approved. These changes will be reported upon once the asset valuations are received and the accounting adjustments calculated.

Appendix 2 shows the estimated value of the Capital Financing Requirement as at 31 March 2010 as £246,871m.

5.2 Prudential Indicators – "Prudence"

The Prudential Indicators for Treasury Management remained unchanged from those previously reported, and are shown in ***Appendix 2.*** The authority is currently operating within approved limits.

5.3 Prudential Indicators – "Affordability"

There is a requirement to analyse and report the capital financing costs, and express those costs as a percentage of the net revenue streams of the authority. These are identified in ***Appendix 2*** attached which currently shows minimal variance from the original budget. However, whilst treasury activity to date has been limited to normal day to day operations, it is clear that the level of investments and the rates of interest achieved to date will impact on the ratio of financing costs to General Fund net revenue stream as updated for additional specified grant approvals received.

5.4 Capital Expenditure and Funding

Capital Expenditure as indicated in ***Appendix 3*** has been updated for the new Awards and the Section 106 monies.

6. FINANCIAL IMPLICATIONS

6.1 Due to the payments related to Job Evaluation being delayed, the level of balances has been higher than anticipated. However, due to the level of interest rates achieved, as indicated in paragraph 4.8, there is likely to be a shortfall in interest income of some £40k

7. PERSONNEL IMPLICATIONS

7.1 There are no personnel implications

8. RECOMMENDATIONS

8.1 Members are asked to note the report

9. REASONS FOR THE RECOMMENDATIONS

9.1 Compliance with the CIPFA "Code of Practice for Treasury Management in the Public Services".

10. STATUTORY POWER

10.1 Local Government Acts 1972 and 2003.

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Cllr. J. Taylor – Chairman, Policy & Resources Scrutiny Committee
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Background Papers:
Treasury Management Working Papers – Accountancy Section.
CIPFA "Code of Practice for Treasury Management in the Public Services"
The Local Government Act 2003
Local Authorities (Capital Finance and Accounting) (Amendment) (Wales) Regulations 2004

Appendices

Appendix 1 – Treasury Management Prudential Indicators – Prudence
Appendix 2 – Capital Finance Prudential Indicators – Affordability
Appendix 3 – Capital Expenditure and Funding