

## **POLICY AND RESOURCES SCRUTINY COMMITTEE - 5TH OCTOBER 2010**

**SUBJECT: TREASURY MANAGEMENT & CAPITAL FINANCING PRUDENTIAL  
INDICATORS MONITORING REPORT – 1ST QUARTER 2010/2011**

**REPORT BY: DEPUTY CHIEF EXECUTIVE**

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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 April to 31st July 2010.
- 1.2 To review the Treasury Management Strategy for 2010/2011 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 2010/2011 were approved by Council on 25th February 2010.

### **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**

### **4.2 Borrowing**

#### **4.3 Loans administered by Caerphilly CBC**

Due to the level of interest rates predicted to be prevalent throughout 2010/2011, 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 £271k. were repaid on maturity.

The portfolio's variable interest rate proportion at 31st July 2010 stood at 20.79%, which is within the Council's determination of 50%.

#### **4.4 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.

#### **4.5 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 £275k. Repayments totalling £30k were made during the period covered by this report.

### **4.6 Investments**

#### **4.7 Long-term Investments**

The Council no longer holds any long-term investments.

#### **4.8 Short-term Investments(Deposits) – up to 364 Days**

The value of short-term deposits at 31st July 2010 was £74.160m and is made up of a spread of periods up to three months. The average rate as at 31st July 2010 for these deposits was 0.27%, which compares unfavourably with the target rate, as detailed in the Annual Strategy 2010/11 report to Council on 25/02/10, of 0.50%.

It should be noted that the average rate reflects the fact that almost 68% (£50.60m) of the current portfolio is deposited with the Debt Management Office at 0.25%, the balance of deposits being with other local authorities.

The latest forecasts of Bank Rate indicate that there is unlikely to be any increase during the current financial year. Subsequently, 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 2010/2011 will be around 0.28%.

#### 4.9 Strategy

In previous monitoring reports (2009/10) members were advised that there was some concern over the level of the UK Credit Default Swap level and the speculation/suggestion that the UK AAA rating could be at risk due to the amount of outstanding debt.

Following the General Election and the budget proposals to reduce the UK debt, the rating agencies are moving the UK outlook to stable. The CDS level is now some 86 points (as at 27/08/10) below the benchmark and the fear of the loss of AAA rating seems to have receded.

However, whilst UK banks are now reporting profits, there is still some concern that the severity of the government's proposals could, in fact, result in a 'double-dip' recession.

Against this still uncertain background, it is proposed not to make any major changes to the current strategy and to continue to place deposits with the Debt Management Office (DMO) and other local authorities. However, in setting the Strategy for 2010/11, a limit of £25m was placed on deposits with local authorities. As local authorities are ultimately supported by the UK government (as is the DMO), it is suggested that this limit be removed. This would allow the Treasury Management team to achieve better rates for more of the deposits, typically 0.30% - 0.35% compared with 0.25% from the DMO.

#### 4.10 Treasury Consultants

Following the tender presentations in March, two consultants were appointed to provide treasury management advice for the next two years, Sector and Arlingclose.

It was determined that the annual costs of less than £50k for the 2 advisors was value for money when compared to the risks associated with the financial market place currently.

#### 4.11 Icelandic Banks

Members are reminded that, to date, some £4.9m has been received in respect of Heritable Bank. This sum represents dividends totalling some 41.25% of the total amount outstanding from Heritable of £10,097,065.89. A further dividend is due to be paid in October 2010, but no details of the sum involved are available at the time of writing but is likely to be around 6%.

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.

### 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 have impacted upon the Capital Financing figures and the Minimum Revenue Provision policy that is currently approved.

**Appendix 2** shows the estimated value of the Capital Financing Requirement as at 31 March 2010 as £315,295m.

## 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 a small variance from the original budget. However, as a result of the premature repayment of PWLB loans in February 2010, interest payable on external debt will reduce by some £825k, which, together with the amount of discount achieved and applied to Revenue in 2010/2011 of £124k, will result in an anticipated net saving of some £878k.

## 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 Despite the level of balances being higher than anticipated, the fact that the rate achieved (as indicated in 4.8) is lower than that assumed in the budget is likely to result in an interest shortfall of some £71k on short-term deposits. However, as a result of the premature repayment of PWLB loans in February 2010, as stated in paragraph 5.3 it is an anticipated net saving of some £878k.

## 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. C. Mann – Cabinet Member for Finance, Resources & Sustainability  
Cllr. J. Taylor – Chairman, Policy & Resources Scrutiny Committee  
Cllr. M.E. Sargent – Vice-Chairman, Policy & Resources Scrutiny Committee

#### 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