AGENDA ITEM
17

EXECUTIVE

DATE:	**30TH MARCH 2009**
SUBJECT	**TREASURY MANAGEMENT STRATEGY STATEMENT & ANNUAL INVESTMENT STRATEGY - 2009/10**
REPORT BY:	**HEAD OF CORPORATE FINANCE**
CONTACT OFFICER:	**B CRICK 01582 546117**

IMPLICATIONS:

LEGAL	✓	**STAFFING**	
EQUALITIES	✓	**COMMUNITY SAFETY**	
FINANCIAL	✓	**RISKS**	✓
OTHER			

CONSULTATIONS:

COUNCILLORS CONSULTED	**SCRUTINY COMMITTEE CONSULTED**
STAKEHOLDERS CONSULTED	**OTHER**

WARDS AFFECTED: None

LEAD EXECUTIVE MEMBER(S): Cllr Harris

RECOMMENDATION(S)

1. Executive recommend to Council that the Treasury Management Strategy Statement and the Annual investment Strategy set out in this report be approved.

REPORT

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

3. The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy which will set out the Council's policies for managing its investments whilst ensuring security and liquidity of funds.

4. The suggested strategy for 2008/09 in respect of the following aspects of the treasury management function is based upon in-house views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor.

5. The strategy covers:

   - treasury limits in force which will limit the treasury risk and activities of the Council;
   - Prudential Indicators
   - the current treasury portfolio position;
   - prospects for interest rates;
   - the borrowing strategy;
   - the annual investment strategy;
   - the extent of debt rescheduling opportunities;
   - any other treasury issues.

6. It is a statutory requirement under section 33 of the Local Government Act Finance Act 1992, for the Council to produce a balanced budget. It should be noted that, 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 :-

   1. increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
   2. 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.

Treasury limits for 2009/10 to 2011/12

7. It is a statutory requirement under section 3 of the Local Government Act 2003, and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is the 'Affordable Borrowing Limit'

8. The Council must have regard to the Prudential code when setting the Affordable Borrowing 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/rent levels is 'acceptable'.

9. Whilst termed an 'Affordable Borrowing Limit', the capital plans to be considered for inclusion incorporate those planned to be financed by both external borrowing and other forms of liability, such as credit arrangements. The affordable borrowing limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

Prudential Indicators for 2009/10 – 2013/14

10. The following Prudential Indicators are relevant for the purposes of setting an integrated treasury management strategy :-

- Authorised limit for external debt
  - Borrowing
  - Other long term liabilities
- Operational Boundary
  - Borrowing
  - Other long term liabilities
- Upper limit for fixed interest exposure
- Upper limit for variable rate exposure (not used)
- Upper limit for variable rate exposure
  - Local Prudential Limit
- Upper limit for total principle sums invested for over 364 days
- Maturity structure of fixed rate borrowing
  - Under 12 months
  - 12 months and within 24 months
  - 24 months and within 5 years
  - 5 years and within 10 years
  - 10 years and above

11. See appendix G of the Budget Report for the recommended level for each indicator.

Current Treasury Portfolio Position

12. The Council's treasury portfolio at 8.03.09 comprised:

	£m	**Principal £m**
Borrowing		
Fixed		
- Public Works Loan Board (PWLB**)**	89.40	
- Money Market	10.00	
Total Fixed		99.40

Variable		38.60
		138.00
Other long term liabilities		28.30
Credit Arrangements		1.40
Total		167.70
Luton Borough Council Investments		
Cash Flow Management		97.21
		97.21
Other Investments		
Investments for Schools		7.90
Investments for London Luton Airport Limited		3.10

Projected Treasury Portfolio Position as at 31.03.09

13. The reorganisation of Bedfordshire County Council has provided an opportunity for the Council to settle liabilities (net) resulting from Local Government reorganisation in 1974 and 1997. In setting the Prudential Indicators for 2008/09, back in February 2008, the potential for this was recognised and the borrowing element of the authorised limit for external debt was set accordingly. The Operational Boundary has stayed with in the limit set (£183.0m), but borrowing has increased and other long term liabilities decreased. A total of £24.679m Public Works Loan Board loans will be transferred over from Bedfordshire County Council with effect from the 31 March 2009 in full settlement of all liabilities (net). This now gives the Council control over all it's debt, and the anticipated position at 31 March will be as set out in below.

Borrowing		
Fixed		
- Public Works Loan Board (PWLB**)**	114.10	
- Money Market	10.00	
Total Fixed		124.10
Variable		38.60
		162.70
Other long term liabilities		-
Credit Arrangements		1.40
Total		164.10
Luton Borough Council Investments		
Cash Flow Management		97.2
		97.2

Other Investments Investments for Schools Investments for London Luton Airport Limited		 7.9 3.1

Borrowing Requirement

14. The borrowing requirement for the next 3 years is based on the Capital Financing Requirement, resulting from prudential borrowing and supported capital expenditure, offset by provisions to repay debt. It is not currently envisaged that any new borrowing will be undertaken during this period due to the substantial level of investments available for utilisation, and the uncertainties in the financial markets. If it is opportune to borrow during the period, then it will be limited to the Capital Financing Requirement as reflected in the table below.

	2009/10	**2010/11**	**2011/12**
	£m	**£m**	**£m**
Potential for new borrowing	53.8	50.6	41.2
Repayment of borrowing	-38.6	-23.6	-23.6
Investments	-15.2	-27.0	-17.6
TOTAL	**0**	**0**	**0**

15. The Council has three LOBO (Lenders Option Borrowers Option) loans totalling £38.6m and the lenders have the right to request repayment during 2009/10. Should they exercise their rights then it is likely that borrowing will need to be undertaken to replace those loans. If the loans are not repaid in 2009/10 then one loan of £15m becomes fixed for 5 years and therefore only £23.5m is liable for repayment in years 2010/11 and 2011/12.

16. The Council does not borrow in order to invest.

Prospects For Interest Rates

17. The Council retains Sector Treasury Services as treasury advisor to the Council and part of their service is to assist the Council formulate a view on interest rates. The following table gives the Sector's central view on both short (base rate) and long term interest rates:-

	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	2009	2009	2009	2009	2010	2010	2010	2010	2011	2011	2011	2011
	%	%	%	%	%	%	%	%	%	%	%	%
Base Rate	0.50	0.50	0.50	0.50	0.5	0.75	1.00	1.25	1.75	2.50	3.25	3.75

					0							
5yr PWLB	2.60	2.45	2.30	2.30	2.30	2.50	2.85	3.15	3.65	3.95	4.20	4.45
10yr PWLB	3.60	3.35	3.20	3.20	3.25	3.35	3.60	3.95	4.30	4.55	4.80	4.85
25yr PWLB	4.15	4.05	4.00	4.00	4.10	4.15	4.35	4.45	4.60	4.85	4.95	5.05
50yr PWLB	4.10	3.95	3.90	3.90	3.95	4.00	4.05	4.25	4.45	4.70	4.85	4.95

Short term interest rates

18. Further to the sub prime crisis in early 2008 and the near collapse of the world banking system in the autumn of 2008, governments around the world were forced to recapitalise and rescue their major banks. Banks stopped lending to each other, economic forecasts sharply reduced and recession was priced into the markets. Oil prices began to fall along with other commodity prices and fears of inflation exceeding 5% disappeared rapidly. In October a co-ordinated global interest rate cut of 0.50% took place and since then the UK has experienced a sharp drop in output, a tightening of credit conditions and weakening consumer spend, leading to four further reductions in the base rate down to the current level of 0.5%. These measures along with the bank's £75billion programme of asset purchases announced in March, the temporary reduction in VAT and falls in commodity prices are expected to provide stimulus to activity as the year progresses.

The table at (16) above shows that bank rate is expected to remain at 0.5% rate throughout the remainder of 2009, before starting to rise midway through 2010 up to 3.75% by December 2011. There is a downside to these forecasts if the recession proves to be deeper and more prolonged than currently expected. Return on the Councils investments will be severely affected with an average rate, on new investments, of between 1.25% - 1.5% expected in 2009/10 and 1.50% - 1.75% in 2010/11. Previously arranged longer term investments will provide an element of cushioning against this gloomy outlook.

Long term interest rates

19. With the current economic outlook in mind it is expected is that, during 2009/10 the 50 year PWLB rate will fall from the current level of 4.22% to around 3.95%, the 25-30 year rate, currently at 4.07%, will hover between 4.00% and 4.10% and the 10 year rate remain at the current level of around 3.20% throughout the year. Variable PWLB rates, throughout the financial year, are expected to be lower than the longer term PWLB rates and will offer another option, compared to simply locking in to longer rates,

Borrowing Strategy and Maturity Profile

20. The above scenario in respect of long term interest rates suggests that, should the Council require additional longer term borrowing during 2009/10,

there are range of options available falling within the Council’s trigger rate of 4%.

21. With the exception of one 2 1/2 year PWLB loan running at 1.86% which was taken as part of a debt restructuring exercise in February 2009, the Council’s debt is mainly concentrated in long dated maturities (42-50 years) which have been, in recent years and still are, running at historically low rates. If additional borrowing is required then consideration would be given to shorter period loans at very low rates providing an opportunity to even out the Council’s debt profile and possibly increase future debt restructuring options.

22. An alternative to borrowing to fund capital expenditure would be to borrow internally by making use of maturing investments during 2009/10. With the base rate, as previously mentioned, expected to remain at 0.50% throughout the financial year and the inevitable knock on effect that will have on investment income, less external exposure of the Councils cash may well be an attractive proposition.

23. Against this background caution will be adopted with the 2009/10 treasury operations. The Head of Corporate Finance will monitor the interest rate market and adopt a pragmatic approach to any changing circumstances, reporting any decisions to the Executive as part of the regular Treasury Management reporting.

24. The main sensitivities of the forecast are likely to be the two scenarios below. The Council’s 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:

- If it were felt that there was a significant risk of a sharp rise in long and short term rates, perhaps arising from a greater than expected increase in world economic activity, or further increases in inflation, then the Council’s debt portfolio position will be re-appraised, and if required, fixed rate funding will be taken whilst interest rates were still relatively cheap,

- If it were felt there was a significant risk of an unexpected sharp fall in long and short term rates due to static or declining growth, or other relevant economic factors, then long term borrowing will be postponed and potential rescheduling from fixed rate funding into short term funding will be considered.

ANNUAL INVESTMENTS STRATEGY

Investment Policy

25. The Council will have regard to the ODPM’s Guidance on Local Government Investments issued in March 2004 and the Chartered Institute of Public Finance and Accountancy’s (CIPFA) Treasury Management in Public services

Code of Practice and Cross Sectoral Guidance Notes. The Council's investment priorities are:-

- the security of capital and
- the liquidity of its investments

26. The Council will aim to achieve the optimum return on its investments with the minimum of risk to the security and liquidity of its assets.

27. The Council will not engage in the unlawful act of borrowing monies to on lend.

28. The Council uses Fitch ratings to establish the credit quality of counterparties and their ratings are monitored on a daily basis. Maximum levels of cash exposure and duration are established for each counterparty dependant upon their rating.

29. A number of UK banks have recently been nationalised, taking them outside the credit criteria used by the council for assessing their credit worthiness. As they are no longer separate institutions in their own right it is impossible for Fitch to assign them an individual rating for their standalone financial strength. Accordingly, Fitch have assigned them with an F rating which means that they have previously failed and are now owned or part owned by the Government. However, these institutions have also been assigned an F+ short term rating and support rating of 1 (which would put them in the highest quality section of the council's lending list), as they effectively take on the creditworthiness of the Government itself. Appendix A has been updated to include this type of institution, providing they are 100% owned or at least 51% owned and also one of the eligible eight banks and building societies supported under the Government guarantee scheme announced on the 8 October 2008.

30. The Council's treasury advisors Sector are kept constantly informed by Fitch in respect of movements in ratings and they, in turn, issue status alerts to the Council. Those of a negative nature will prompt immediate action and, dependant upon the magnitude, counterparties will be removed from Council's lending list (as in the case of Icelandic Banks in April 2008) or downgraded to the relevant section within the Council's lending criteria.

31. Investment instruments identified for use by the Council are shown at appendix A which details Specified Investments (investments with maturities up to 1 year) and Non Specified Investments (investments 1 year and over to a maximum of 50% of total investments)

32. The Council currently has non-specified investments totalling £34.5m, 20.5m callable deposits (in the current and foreseeable interest climate, it is likely that all callable rights will be exercised on the next call dates) and £14m repayable on the maturity date. Callable deposits are those where the bank has the right to end the arrangement on specified dates prior to the final maturity date.

Bank/Building Society	£m	Maturity Date	%	Terms	Next Call Date
National Australia	3.0	4.05.10	5.60	6 monthly Call	5.05.09
Nationwide B.S	2.0	7.05.10	5.84	Maturity	
Barclays	2.0	18.08.10	5.60	Maturity	
Nationwide B.S	10.0	9.05.11	6.08	Maturity	
HSBC	2.0	15.12.11	3.65	6 monthly Call	15.06.09
Lloyds TSB	2.5	3.09.12	6.20	1st call 2yr, then 6 monthly	1.09.10
HSBC	1.5	17.12.12	3.60	1st call 1yr then 6 monthly	15.12.09
Dexia Belgium	1.5	31.01.13	6.00	1st call 18 mths then 6 mths	31.07.09
Barclays	3.0	28.04.13	6.12	1st call 3yrs, then yearly	26.04.11
Barclays	5.0	31.05.13	6.90	1st call 2yrs, then 6 monthly	2.06.10
Dexia Belgium	2.0	3.06.13	7.02	1st call 1yr, then 6 monthly	3.06.09

Investment Strategy

33. A Base rate of 1/2% is forecast for the entire financial year in 2009/10 with the prospects of an average of less than 1% for 2010/11. These historically low rates will effect decisions in respect of investment duration and at this stage it is difficult to envisage entering into any long term deals. Investments will , in the main, be kept short to cover monthly shortfalls of cash. Reserve accounts, Deposit accounts and Money Market Funds, and Government Liquidity Funds which currently operate at between 1/4% around 1/2% above base rate, will be used to provide liquidity for daily cash flow purposes. The aim at all times will be to make investments that are safe (so far as any investments can be safe in the current market) and to achieve at least base rate on every investment.

34. Investments in Treasury Bills and Certificates of Deposit will be considered, though it will be necessary to appoint a custodian to arrange transactions.

35. The historically low rates predicted for the next few years will have a considerable impact on the Council's investment income, though income on the non specified investments shown above will provide some cushioning.

36. Based on cash flow forecasts it is anticipated that surplus funds available to invest during 2009/10 will range between £50m and £75m. Programmed capital spend for 2010/11 is £141.4m with an additional £104.3m programmed for 2011/12. It is anticipated that there will be an element of rephasing on timing of this spend in both years, and although a large proportion (59%) of this spend is covered by government grants and third party contributions etc there is likely to be an adverse effect on cash flow due to the delay in receiving this cash.

37. The minimum amount/percentage of overall surplus funds that the Council will hold in short term (less than 1 year) investments is 50%**.**

38. Giving due consideration to the Council's level of balances over the next 5 years, the need for liquidity, its spending commitments and provision for contingencies the Council is recommended to determine that 50% of overall surplus funds can be prudently committed to non-specified investments (i.e those with a maturity exceeding a year).

39. The Council has identified a trigger rate of at least 10% above the prevailing base rate when considering the use of non-specified investments and at all times the Council's Treasury Management consultants will form part of the discussions and subsequent recommendations and actions.

Investments defined as capital expenditure

40. The acquisition of share or loan capital in any corporate body is defined as capital expenditure under section 16(2) of the Local government Act 2003. Such investments will have to be funded from capital or revenue resources and be classified as non-specified investments.

41. Any loan or grant to another body for capital expenditure by that body will also be deemed, by regulation, to be capital expenditure by the council. It is therefore important for the Council to clearly identify if the loan or grant has been made for policy reasons or if it is an investment for treasury management purposes in which case it would be governed by the framework set for specified and non specified investments.

Provisions for Credit - related losses

42. If any of the Council's investments appeared at risk of loss to default (ie a credit-related loss rather than a loss due to a fall in price or movement in interest rates) the Council will make revenue provision of an appropriate amount.

External Cash Fund Management

43. At present the Council does not employ the services of an external Fund Manager. This is kept under review and if the Council's treasury advisors consider that an external Fund Manager would be able to provide better value, net of fees, for a proportion of the Council's investments, then an external Fund Manager will be employed again.

End of year Investment Report

44. At the end of the financial year the Council will prepare a report on the investment activity as part of the Annual Treasury Report.

Debt Rescheduling

45. The introduction on 1 November 2007 of different PWLB rates for new borrowing as opposed to early repayment of debt and the setting of the spread between the two rates of 40-50 basis points for the longest period loans, has meant that opportunities to make savings from restructuring within the PWLB are now few and far between. Should restructuring be undertaken alternative borrowing such as LOBO's (Lenders option Borrowers Option) and other market loans will have to be considered along with varying PWLB maturity periods, although the amount of borrowing made by LOBOs requires careful consideration, since the borrower does not have the ability to initiate restructurings of such loans in future. Any restructuring will be carried out in accordance with the strategy position outlined in paragraphs 20-24 above and prudential indicators.

46. The reasons for any restructuring to take place will include:

- o the generation of cash savings;
- o in order to enhance the balance of the long term portfolio (amend the maturity profile and/or the balance of volatility);
- o in order to help fulfil the strategy outlined in paragraphs 20-24 above.

47. All rescheduling will be reported to the Executive as part of the standard Treasury Management Activity Report.

Large Scale Voluntary Transfer (LSVT)

48. Any potential transfer will have treasury management implications and these would need to be considered by the Executive if the situation ever arises.

Other Issues

49. Consideration may be given to funding PFI arrangements, though any council involvement will have to be approved by the relevant Government department and H.M Treasury. The treasury implications of PFI arrangements will need to be fully considered by Executive as part of the business case for each proposed PFI.

LEGAL IMPLICATIONS

50. There are no legal implications in respect of this report and this has been agreed with Brenda Vale in Legal Services on the 16 March 2009.

EQUALITIES,COHESION and INCLUSION IMPLICATIONS

51. The report has no direct or indirect equality, cohesion or inclusion implications except so far as it reports on investments and borrowings which may directly or indirectly have implications dependant on how those investments are managed and how that borrowing is used. This was agreed by the Performance Review Manager (CCS) on the 16 March 2009.

FINANCIAL IMPLICATIONS

52. The strategy determines the approach to Treasury Management throughout the year. The Council's budget has been prepared on the basis that this strategy will be followed. Should the financial markets not follow the trends predicted on this report , there may be implications for the budget. As the Council's current borrowing is mainly at fixed interest rates, a sustained increase in interest rates will improve the Council's financial position. A reduction in interest rates will have an adverse effect on the Council's financial position and management action will be necessary to mitigate this. This paragraph has been agreed by the Head of Corporate Finance on 12 March 2009.

RISK IMPLICATIONS

53. Treasury Management is an area of significant risk, particularly in relation to security and probity of investments. The strategy has been prepared in accordance with advice from the Council's Treasury Management advisors, and their advice is also taken on significant treasury decisions. Activity is undertaken in accordance with provisions of the Council's Treasury Management Practices (TMPs) which include a substantial section on risk, in order to manage and minimise , so far as possible , the risks involved.

OPTIONS

54. The Executive has the option to approve or amend these strategies.

APPENDIX

55. Appendix A – Specified and Non-Specified Investments

BACKGROUND PAPERS

CIPFA publication – Treasury Management in the Public Services – Code of Practice and Cross Sectoral Guidance Notes.
Sector guidance notes
Prudential Code