Report to: **Cabinet**

Subject: **Prudential Code Indicator Monitoring 2008/09 and Quarterly Treasury Activity Report**

Date: **5 February 2008**

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1. PURPOSE OF REPORT

To inform Members of the performance monitoring of the 2008/09 Prudential Code Indicators, and to advise Members of the quarterly treasury activity as required by the Treasury Management Strategy

2. BACKGROUND

The Local Government Act 2003 introduced the new Prudential Framework for Local Authority Capital Investment. The key objectives of the Code are:

1. That capital investment plans are affordable, prudent and sustainable

2. That treasury management decisions are taken in accordance with good professional practice

3. That local strategic planning, asset management and proper option appraisal are supported

To demonstrate that these objectives have been fulfilled, the Prudential Code details the indicators that must be set and monitored. The indicators are designed to support and record local decision-making, and not to be comparative performance indicators.

Approval of the Prudential Indicators for 2008/09 to 2010/11 was given by Full Council at its meeting on 27 February 2008. The Prudential Code requires the Chief Financial Officer (ie. the Head of Corporate Services) to establish procedures to monitor performance against all forward-looking prudential indicators, and to report any significant deviations from expectations.

3. PRUDENTIAL CODE INDICATOR MONITORING

Appendix 1 details the prudential indicators for 2008/09, together with the monitoring position at 31 December 2008.

Section 1 – Estimates - details those indicators that are based on estimates of expected outcomes, and include four key indicators of affordability. The following indicators are monitored on a quarterly basis, and Appendix 1 compares the approved indicators against the projected outturn for 2008/09 and shows variances on some of the indicators, as described below:

1. Ratio of Financing Costs to Net Revenue Stream

   The projected outturn for Non HRA shows a reduction against the approved indicator. Despite the credit crunch, additional investment interest has been generated in 2008/09 by the prudent investment of borrowing taken in advance of need at the end of 2007/08. This has more than offset the historically low rates currently being achieved, as well as the Public Works Loan Board (PWLB) interest payable on the additional borrowing.

   The projected outturn for HRA is lower than the approved indicator, due to a reduction in the revenue contribution required to finance capital expenditure, as a result of the Large Scale Voluntary Transfer (LSVT).

2. Capital Expenditure

   The latest projected outturn shows that Non HRA capital expenditure is expected to be lower than originally anticipated. This is due to slippage on the 2008/09 capital programme, partially offset by the inclusion of approved carry-forward requests from 2007/08. HRA capital expenditure is expected to be lower than anticipated due to the LSVT.

2. Capital Financing Requirement (CFR)

   No new external borrowing had been undertaken at the end of December 2008, however, further borrowing in advance of need for future years may be undertaken before the year-end if interest rates are considered to be particularly beneficial. As always, advice will be taken from Sector Treasury Services in this regard.

The estimated closing CFR for 2008/09 is considerably lower than was originally anticipated. The initial indicator assumed a higher application of borrowing to capital expenditure in the previous year, 2007/08, than was actually undertaken. A proportion of this borrowing will be applied at the end of 2008/09, but the effect of this on CFR will not be apparent until 2009/10.

The CFR has also been lowered considerably by CLG's repayment of £3.95m of overhanging debt following the LSVT. Members are advised that advice has been sought from Sector, to ensure that the position reported with regard to the CFR is technically correct, however, since each LSVT arrangement is different, a conclusive answer has not yet been received.

Section 2 – Limits - details those indicators that are based on limits, beyond which activities should not pass without management action. These include two key indicators of affordability and five key indicators of prudence.

Affordability

1. Authorised Limit for External Debt

2. Operational Boundary for External Debt

Prudence:

1. Net Borrowing and the Capital Financing Requirement

2. Upper Limit for Fixed Interest Exposure – represented by the maximum permitted net outstanding principal sum borrowed at fixed rates. Please note that a negative indicator represents net investment.

3. Upper Limit for Variable Interest Rate Exposure – represented by the maximum permitted net outstanding principal sum borrowed at variable rates. Please note that a negative indicator represents net investment.

4. Upper limits for the maturity structure of borrowing

5. Upper limits for principal sums invested for periods over 364 days

Appendix 1 shows the actual position as at 31 December 2008 and demonstrates that all activities are contained within the currently approved limits.

4. QUARTERLY TREASURY ACTIVITY REPORT

The Treasury Activity Report for the quarter ended 31 December 2008 is attached at Appendix 2, in accordance with the Treasury Management Strategy.

Members are advised that the Council's counterparty list has been reviewed, and that only institutions with the very highest ratings are included. Treasury advisers have indicated that the Irish economy is facing increasing difficulties, and that no further deposits should be made with Irish banks at present. This advice has been followed, with all Irish deposits falling due for repayment by 31 March 2009. Rigorous monitoring of the counterparty list will continue.

Members are advised that the Fitch credit rating for HBOS, and accordingly Bank of Scotland, has recently fallen outside the criteria set for counterparties. Accordingly, steps are currently being taken to place monies held with HBOS and BOS with alternative counterparties. However, given that HBOS is now effectively 70% owned by the AAA sovereign rated British Government, it is considered that the risk attached to these counterparties is negligible, and permission to continue their use is sought.

5. RECOMMENDATIONS

1) To authorise the Head of Corporate Services the discretion to continue the use of HBOS and Bank of Scotland as counterparties for Treasury Management purposes, despite their current rating falling outside the previously approved limits.

2) Members are asked to note the Prudential Indicator Monitoring at Appendix 1 and the Treasury Activity Report at Appendix 2.