Report to: **Cabinet**

Subject: **Prudential Code Indicator Monitoring 2010/11 and Quarterly Treasury Activity Report**

Date: **2 September 2010**

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1. PURPOSE OF REPORT

To inform Members of the performance monitoring of the 2010/11 Prudential Code Indicators, and to advise Members of the quarterly treasury activity as required by the Treasury Management Strategy. CIPFA issued a revised Code of Practice for Treasury Management in November 2009, following consultation with local authorities during the year. The revised Code suggests that members should be informed of Treasury Management activities at least twice a year, and preferably quarterly. The Council have long adopted this “best practice”, and are fully compliant with the new Code.

2. BACKGROUND

The Local Government Act 2003 introduced the Prudential Framework for Local Authority Capital Investment, the key objectives being:

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 Prudential and Treasury Management indicators that must be set and monitored. These indicators are designed to support and record local decision-making, and not to be comparative performance indicators.

Consideration was given by Cabinet to the indicators for 2010/11 to 2012/13 at its meeting on 18 February 2010, and these were subsequently approved by Full Council on 3 March 2010. 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. ECONOMIC BACKGROUND

The key development in the first quarter was the emergency budget on 22 June 2010, which unveiled plans by the Chancellor to severely tighten fiscal policy, particularly with respect to households and the public sector. Plans for social security payments were also scaled back. Activity surveys have suggested that the recovery gathered pace during the first quarter, and encouragingly the labour market has shown some tentative signs of improvement. The UK's trade position continued to deteriorate despite the lower pound, however on amore positive note, some commentators suggested that inflationary pressures were finally beginning to ease.

The Monetary Policy Committee (MPC) continued to keep base rates on hold at 0.5%, and is currently expected to remain at this level until early in 2011, when it will start to rise, reaching 3.75% by March 2013. This forecast is based on the assumptions of a moderate economic recovery, and inflation being below target in two years time.

4. PRUDENTIAL CODE INDICATOR MONITORING

Appendix 1 details the Prudential and Treasury Management indicators for 2010/11, together with the monitoring position at 30 June 2010.

1. Prudential Indicators

These are based on estimates of expected outcomes, these are four key indicators of "affordability". They are monitored on a quarterly basis, and Appendix 1 compares the approved indicators against the projected outturn for 2010/11, and shows variances on some of the indicators, as described below:

a) Capital Expenditure

The latest projected outturn shows that capital expenditure is expected to be higher than originally anticipated, due to the inclusion of approved carry-forward requests from 2009/10.

b) Ratio of Financing Costs to Net Revenue Stream

The projected outturn shows a reduction against the approved indicator, due largely to the decision to no longer provide for a voluntary MRP in respect of serviced debt. Offsetting this, a further £2m of PWLB borrowing was undertaken in May 2010 and invested in the short term, pending its use. This has resulted in a "cost to carry" of approximately £20,000, however extremely favourable PWLB rates made this a prudent decision. As always, advice was taken from the Council's Treasury Advisers with regard to the timing of borrowing, and this will continue to be the case.

c) Capital Financing Requirement (CFR)

As discussed at b) above, £2m of new external borrowing had been undertaken as at the end of June 2010, and further borrowing in advance of need for future years may be undertaken before the year-end if interest rates continue to be beneficial. Advice regarding the timing of borrowing will continue to be taken from Sector Treasury Services. The estimated closing CFR for 2010/11 is lower than originally anticipated, due to slippage in the capital programme and a reduced need for the use of borrowing in 2009/10.

2. Treasury Management Indicators

These are based on limits, beyond which activities should not pass without management action. They include two key indicators of "affordability" and four key indicators of prudence.

"Affordability"

a) Authorised Limit for External Debt

b) Operational Boundary for External Debt

"Prudence"

c) 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.

d) 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.

e) Upper limits for principal sums invested for periods over 364 days

f) Upper limits for the maturity structure of borrowing

Appendix 1 shows the actual position as at 30 June 2010 and demonstrates that all activities are contained within the currently approved limits.

5. QUARTERLY TREASURY ACTIVITY REPORT

The Treasury Activity Report for the quarter ended 30 June 2010 is attached at Appendix 2, in accordance with the Treasury Management Strategy. For reference, definitions of LIBOR and LIBID are given below.

LIBOR is the London Interbank Offered Rate

LIBOR is the interest rate at which the London banks are willing to offer funds in the inter-bank market. It is the average of rates which five major London banks are willing to lend $10 million for a period of three or six months, and is the benchmark rate for setting interest rates for adjustable-rate loans and financial instruments.

Ie. the London banks are LENDING to each other, which affects the rate at which the banks will lend to other parties eg. local authorities, ie. Gedling are BORROWING money

LIBID is the Interbank BID (LIBID) rate

LIBID is the interest rate at which London banks are willing to borrow from one another in the inter-bank market. It is the average of rates which five major London banks willing to bid for a $10 million deposit for a period of three or six months.

Ie. the London banks are BORROWING from each other, which affects the rates at which they will borrow from other parties eg. local authorities, ie. Gedling are LENDING money.

6. RECOMMENDATION

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