Report to: **Cabinet**

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

Date: **3 February 2011**

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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 AT QUARTER 3

Sentiment has focused on the potential for a faster US economic recovery, which brings with it an increase in the potential for inflationary pressures and concerns as to whether the Federal Reserve will act quickly and resolutely enough to stop those pressures from building.

In the UK, sentiment has shifted in terms of concerns around the build up of inflationary pressures, and there is an increase in concern as to the credibility of the Monetary Policy Committee when inflation has been so much above its 2% target for such a long time. The MPC will be particularly concerned about the public's inflation expectations, and there is a risk that they may feel the need to take action earlier than Q4, for damage limitation to its credibility. However, inflation in the latter half of 2011 and beyond is still forecast by the Bank of England to fall back rapidly once the increase in the rate of VAT to 20% (which is likely to add about 1.5% to CPI), this month, falls out of the index after twelve months. There are therefore still grounds for expecting the inflationary threat to calm down.

In line with widespread comment that the Bank's previous forecasts for growth were optimistic, the November Inflation Report downgraded the forecast for 2011 to about 2.3%. However, the Bank then slightly upgraded its forecast for growth in 2012 to around 3%, helped by the continuation of strong monetary policy stimulus through an exceptionally low Bank Rate and the current level of Quantitative Easing. In addition, there was confident optimism that the private sector would be able to absorb 500,000 people likely to lose their jobs from the public sector, as the UK economy rebalanced to being more focused on exporting.

The FTSE 100 share index has had a successful run over the last few months and has broken through the 6,000 barrier.

4. PRUDENTIAL CODE INDICATOR MONITORING

Appendix 1 details the Prudential and Treasury Management indicators for 2010/11, together with the monitoring position at 31 December 2010.

1. <u>Prudential Indicators</u>

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 slightly higher than originally anticipated, due both to the inclusion of approved carry-forward requests from 2009/10, and to amendments to the programme requested during the quarterly monitoring process.

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, £2m of PWLB borrowing was undertaken in May 2010 and a further £1m in August 2010. These sums have all been invested in the short term, pending their use. No further borrowing has been undertaken during Quarter 3.

c) Capital Financing Requirement (CFR)

As discussed at b) above, £3m of new external borrowing has been undertaken as at the end of September 2010, and further borrowing in advance of need for future years may be undertaken before the year-end if interest rates were to be particularly 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 – one such investment was made during the period, and this matures in October 2012. This is classified as a “non specified investment” by way of its term, however it is within both the Treasury Indicator discussed here, and the limits set out for non specified investments in the Annual Investment Strategy approved by Members on 3 March 2010.

f) Upper limits for the maturity structure of borrowing

Appendix 1 shows the actual position as at 31 December 2011 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 31 September 2011 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.

APPENDIX 1

Prudential and Treasury Indicators for 2010/11
Quarter 3 ended 31 December 2010

Prudential Indicators

	2010/11 Original Estimate	2010/11 Position at 31 December 2010
a) Capital Expenditure	3,819,400	4,021,000
b) Ratio of Financing Costs to Net Revenue Stream	4.76%	4.11%
c) Capital Financing Requirement (CFR)	£11,288,260	£10,586,251
d) Net Borrowing and CFR	£13,258,526	-£3,688,423
e) Incremental impact of new 2010/11 capital investment decisions	£0.52	

Treasury Management Indicators

	2010/11 Original Estimate	2010/11 Position at 31 December 2010
a) Authorised Limit for External Debt:		
Borrowing	£15,000,000	£9,811,577
Other Long Term Liabilities	£1,500,000	£0
Total Authorised Limit	**£16,500,000**	**£9,811,577**
b) Operational Boundary for External Debt:		
Borrowing	£14,000,000	£9,811,577
Other Long Term Liabilities	£1,500,000	£0
Total Operational Boundary	**£15,500,000**	**£9,811,577**
c) Upper limit for fixed interest exposure (Max o/s net Borrowing)	£13,500,000	-£188,423
Local indicator-Investment only	100%	74.07%
Local indicator-Borrowing only	100%	100%
d) Upper limit for variable interest exposure (Max o/s net Borrowing)	£2,000,000	-£3,500,000
Local indicator-Investment only	100%	25.93%
Local indicator-Borrowing only	50%	0%
e) Upper limits for maturity structure of outstanding borrowing during 2011/12 (Lower limit 0% in all cases)		
Under 1 year	20%	0%
1-2 years	20%	0%
2-5 years	35%	20.4%
5-10 years	50%	10.2%
Over 10 years	100%	69.4%
f) Upper limits for principal sums invested for periods **over** 364 days		
Maturing beyond 31 March 2012	£5,000,000	£1,500,000
Maturing beyond 31 March 2013	£3,000,000	£1,500,000
Maturing beyond 31 March 2014	£0	£0

APPENDIX 2

Treasury Activity Report 2010/11 for the Quarter ended 31 December 2010

	Position at 1 October	Loans Made Quarter 3	Loans Repaid Quarter 3	Position at 31 December
	£	£	£	£
Long Term Borrowing				
PWLB	**9,811,577**	**0**	**0**	**9,811,577**
Temporary Borrowing				
Local Authorities	0	0	0	0
Public Corporations	0	0	0	0
Central Government	0	0	0	0
Banks and other Institutions	0	0	0	0
Total Temporary Borrowing	**0**	**0**	**0**	**0**
TOTAL BORROWING	**9,811,577**	**0**	**0**	**9,811,577**
Temporary Investment				
Bank of Scotland	5,000,000	2,500,000	2,500,000	5,000,000
Barclays	0	3,000,000	0	3,000,000
HSBC Treasury	0	9,881,000	9,881,000	0
Royal Bank of Scotland	5,000,000	10,265,000	12,265,000	3,000,000
Santander-Abbey	4,650,000	5,180,000	7,330,000	2,500,000
Total Banks	**14,650,000**	**30,826,000**	**31,976,000**	**13,500,000**
Building Societies	0	0	0	0
Debt Management Office	0	0	0	0
Local Authorities and Others	0	0	0	0
TOTAL INVESTMENT	**14,650,000**	**30,826,000**	**31,976,000**	**13,500,000**
NET BORROWING / (INVESTMENT)	**(4,838,423)**	**(30,826,000)**	**(31,976,000)**	**(3,688,423)**

Temporary Borrowing and Lending Statistics at 31 December 2010

Investment

Fixed Rate	4,500,000	16,381,000	10,881,000	10,000,000
Variable Rate	10,150,000	14,445,000	21,095,000	3,500,000
TOTAL INVESTMENT	**14,650,000**	**30,826,000**	**31,976,000**	**13,500,000**

Proportion of Fixed Rate Investment	74.07%
Proportion of Variable Rate investment	25.93%
Temporary Investment Interest Receivable	£92,034
Equated Temporary Investment	£8,431,700
Weighted Average Interest Rate Received	1.09%
7 Day LIBID (Benchmark)	0.43%
3 Month LIBID	0.60%

Borrowing

Temporary Borrowing Interest Payable	-
Equated Temporary Borrowing	-
Weighted Average Interest Rate Paid	-
7 Day LIBOR (Benchmark)	0.55%