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CABINET - 6 FEBRUARY 2008

TREASURY MANAGEMENT STRATEGY REPORT 2008/09

1. INTRODUCTION

The Prudential Code for Capital Finance in Local Authorities (The Code) was introduced with effect from 1 April 2004. The Code gives the Council greater freedom for future capital investment plans.

Under the Code, the Council must approve, revise and monitor a minimum number of mandatory prudential indicators. The indicators cover the affordability and prudence of capital expenditure, external debt and the Council's treasury and investment strategies for each financial year. These can be supplemented with local indicators if required.

The purpose of the indicators is to provide a framework for capital expenditure decision making. It highlights the level of capital expenditure and the impact of that expenditure on borrowing and investment levels, which will affect the treasury management strategy for future years.

Each year's capital expenditure programme is financed by using a variety of sources of funding. One of these sources is debt. Each year the programme generates a borrowing requirement and this is the amount of loan that the council will have to raise to adequately fund the programme. This borrowing requirement can also be met by using cash reserves and therefore deferring the raising of loans until a later date. Loans can be raised in advance or in arrear of generating the borrowing requirement. The most beneficial time to raise loans will depend on prevailing interest rates and the Executive Director, under delegated powers, will determine the most beneficial form of borrowing at the most advantageous time. It is unlikely that loans will be raised in the immediate future as members have expressed a wish to remain "debt free" currently.

The production of the treasury management strategy each year is a requirement of the CIPFA Code of Practice on Treasury Management. This strategy incorporates investment guidance issued by the ODPM in March 2004.

The indicators for 2008/09 must be agreed prior to 1 April 2008. In addition, the indicators for the following 2 years are also estimated. This informs Members of the treasury management requirements of the estimated capital expenditure and the implications of this expenditure in the medium term.

This report informs members of the treasury strategy and recommends the prudential indicators for 2008/09.

2. PRUDENTIAL INDICATORS AND STRATEGIES FOR 2008/09

2.1 The reporting of the main prudential indicators, in accordance with the requirements of The Code, is shown at appendix 1.

2.2 The Treasury Strategy, including the specific treasury management prudential indicators and the investment strategy, is shown at appendix 2.

3. RECOMMENDATIONS

That Cabinet recommends Council to:-

3.1 adopt the prudential indicators at appendix 1, and

3.2 approve the treasury management strategy and adopt the treasury prudential indicators at appendix 2.

Further Information
Please contact Jan Hawker, Treasury Management Accountant Ext. 5722
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Background Papers
The Prudential Code, CIPFA Guidance Notes and ODPM Investment Guidance.
General Fund Revenue Budget and Capital Programme 2008/09(on this agenda)
Expenditure Plan Proposals (Cabinet 2 January 2008)

APPENDIX 1

THE MAIN PRUDENTIAL INDICATORS

1. CAPITAL EXPENDITURE AND CAPITAL FINANCING REQUIREMENT

1.1 Each year the Council approves a programme of capital expenditure. Some of this expenditure will be supported by the Government; the remainder will need to be financed from the Council's own sources. Some of this expenditure that cannot be financed from resources such as capital receipts, capital grants and other sources will impact on the Council's underlying need to borrow.

1.2 This underlying need to borrow is called the Capital Financing Requirement (CFR).

1.3 Future capital expenditure and its financing will impact on the CFR. If any of the financing of the capital expenditure is met by raising a loan, either immediately or in the future, the CFR will alter by the amount of the loan. Any provision that is made to repay loan in the future will reduce the CFR.

1.4 Capital Expenditure

The capital expenditure projections and the CFR are shown below. A more detailed schedule for these projections is included in the main budget report on this agenda.

Capital Expenditure	2006/07 Actual £000	2007/08 Forecast £000	2008/09 Estimate £000	2009/10 Estimate £000	2010/11 Estimate £000
Total expenditure	11,757	13,608	15,525	17,294	9,562
Capital receipts	998	1,459	3,013	800	500
Capital grants	1,235	1,313	1,723	8,468	1,253
Capital reserves	590	1,744	1,686	283	-268
Developers Contr.	529	732	257	43	0
Revenue	6,809	5,212	6,464	5,945	5,945
Net capital borrowing requirement	**1,596**	**3,148**	**2,382**	**1,755**	**2,132**

1.5 Capital Financing Requirement

Expenditure will impact directly on the overall CFR if a borrowing requirement arises as shown at 1.4 above. For the purposes of this report any assumed borrowing requirement is met by using cash held in reserves, rather than raising loans, as Members have expressed the wish that the Council should remain debt free currently. In reality consideration can be given to raising loans from external organisations rather than using the cash held in the Council's reserves depending on the forecast of interest rates over the medium term and the Council's internal cash flow.

The Capital Financing Requirement is reduced by the amount of any provision that is made to repay loan in the future.

The cumulative net projections for the CFR at each year-end are shown below:

Capital Financing Requirement (CFR)	**2007/08 Revised £m**	**2008/09 Estimate £m**	**2009/10 Estimate £m**	**2010/11 Estimate £m**
CFR–Non Housing	4.8	5.7	5.5	5.5
CFR - Housing	1.9	1.9	1.9	1.9
Total CFR at year end	6.7	7.6	7.4	7.4
Movement in CFR	**2.0**	**0.9**	**-0.2**	**0.0**
The movement in CFR is represented by				
Net Financing need	3.1	2.4	1.7	2.1
MRP movement	-1.1	-1.5	-1.9	-2.1
Movement in CFR	**2.0**	**0.9**	**-0.2**	**0.0**

1.6 External Debt and Investments

All of the indicators throughout this report assume that long-term debt is not raised as the borrowing requirement is incurred but that the council remains "debt free" for the time being. This is the preference expressed by members currently. Short-term debt can be raised for cash flow purposes without compromising the "debt free" status. The expected impact of the capital expenditure decisions on the Council's debt and investment position are shown below:

	2006/07 Actual £m	**2007/08 Revised £m**	**2008/09 Estimate £m**	**2009/10 Estimate £m**	**2010/11 Estimate £m**
External Debt					
Total Debt at 31 March	0.0	0.0	0.0	0.0	0.0
Investments					
Investments at 31 March	22.6	17.6	11.1	9.1	7.6

The movement of the total investments of £5 million between the 2006/07 actual and the 2007/08 revised estimates reflects the estimated use of investments to finance capital expenditure during 2007/08 (-£5.5m), offset by the anticipated receipt of new sums of developers' contributions and capital receipts (£0.5m).

The reduction in the investment balance between 2007/08 and 2008/09 reflects the use of loan, capital receipts, developers' contributions, and capital reserves to finance capital purchases in 2008/09.

2. LIMITS TO BORROWING ACTIVITY

2.1 Net External Borrowing

The Council needs to make sure that net external borrowing in 2008/09 does not exceed the CFR at the end of 2008/09 or either of the two subsequent years. This allows some flexibility for limited borrowing in advance of the need to spend. This is crucial to effective treasury management as it means that treasury decisions can be made when interest rates are at the most beneficial to the Council. Members have expressed a wish that borrowing will not be undertaken currently but this Prudential Indicator still requires member approval.

Net External Borrowing	2007/08 Comparator £m	2008/09 Estimate £m	2009/10 Estimate £m	2010/11 Estimate £m
Gross Borrowing	0.0	0.0	0.0	0.0
Investments	17.6	11.1	9.1	7.6
Net Borrowing	-17.6	-11.1	-9.1	-7.6
CFR at year end	6.7	7.6	7.4	7.4

As net borrowing of -£11.1m in 2008/09 does not exceed the CFR in any year up to 2010/11 this indicator is satisfied.

2.2 The Authorised Limit

This is the limit beyond which borrowing is prohibited and needs to be set by Members for each financial year. It reflects the level of borrowing that, while not desired or sustainable, could be required in the short-term. It is the maximum borrowing required with some headroom for unexpected cash flow movements and includes both temporary borrowing for cash flow purposes and long term borrowing to finance capital expenditure.

Authorised limit for external debt	2007/08 Revised £m	2008/09 Estimate £m	2009/10 Estimate £m	2010/11 Estimate £m
Total Borrowing	24	25	26	28

2.3 The Operational Boundary

This indicator is based on the probable external debt during the course of the year. It is not a limit and the borrowing of the Council could vary around this boundary for short times during the year. It is a warning indicator to flag up total borrowing and to help ensure that the Authorised Limit is not breached.

Although the Council is “debt free” currently and there is no immediate plan to raise loans for capital expenditure this indicator must still be set and monitored according to the code as there may be borrowing of a temporary nature from time to time.

Operational boundary for external debt	2007/08 Revised £m	2008/09 Estimate £m	2009/10 Estimate £m	2010/11 Estimate £m
Total Borrowing	2	2	2	2

3. AFFORDABILITY INDICATORS

The previous sections cover the prudential indicators for capital and borrowing. This section assesses the affordability of the capital investment plans. These provide an indication of the impact of the capital programme on the Council’s finances.

3.1 Financing Costs

This section shows the cost of financing the Council's borrowing. If the Council finances some of the capital expenditure programme from borrowing, a charge must be made to revenue to repay that borrowing in the future even if no loans have actually been raised. This is called the MRP. This Council's MRP is to repay the internal borrowing that is being used to finance the purchase of vehicles, plant and equipment. The MRP is equal to the depreciation charge on that equipment.

MRP costs incurred are offset by savings made by the Council no longer leasing assets or funding them from a Replacements and Renewals Reserve.

The following table shows the estimated financing costs for the period from 2006/07 to 2010/11.

Financing Costs	2006/07 Actual £000	2007/08 Revised £000	2008/09 Estimate £000	2009/10 Estimate £000	2010/11 Estimate £000
Loss of interest on cash usage	183	280	335	214	99
Additional RCCO	0	-100	100	0	0
Revenue Savings-no longer leasing or using R&R Fund	-314	-345	-270	-319	-193
Replacement for MRP	595	551	356	425	184
Total Financing Costs	464	386	521	320	90

3.2 Ratio of financing costs to net revenue stream

3.2.1 The net revenue stream is the amount of revenue expenditure met from government grant and local tax.

3.2.2 The following table shows the effect of the estimated financing cost, against the estimated net revenue stream. This assesses the cost of borrowing to the revenue account.

	2006/07 Actual	2007/08 Revised	2008/09 Estimate	2009/10 Estimate	2010/11 Estimate
Non - HRA	2.1%	1.8%	2.3%	1.4%	0.4%
HRA	0.0%	0.0%	0.0%	0.0%	0.0%

3.3 Estimates of the incremental impact of capital investment decisions on the Band D Council Tax

3.3.1 This table shows how the capital programme recommended in the budget report will affect the Band D Council Tax.

3.3.2 This will not be the total estimated increase/reduction in the Council Tax as there will be savings/additional expenditure in other areas to offset the change in the revenue charge for capital. This indicator shows the impact on the Council Tax of the revenue implications of the capital programme in isolation from any other expenditure that may generate a revenue charge.

	Proposed Budget 2008/09	Forward Projection 2009/10	Forward Projection 2010/11
Change to Council Tax-Band D	5.0%	2.9%	0.8%
Change to Council Tax cost year on year	£7.22	£4.44	£1.24

3.4 Estimates of the incremental impact of capital investment decisions on housing rent levels

3.4.1 The Council has adopted the Government's rent restructuring policy. As such, the unsupported element of the capital programme has no impact on rent levels. Any revenue financial implications of the programme are covered from balances or through adjustments to other revenue budgets.

3.4.2 The indicator below shows the cost of proposed changes in the housing capital programme, as recommended in this budget report, expressed as a change in weekly rent levels if the Government's rent restructuring policy had not been adopted.

	Proposed Budget 2008/09	Forward Projection 2009/10	Forward Projection 2010/11
Change to the Weekly Housing Rent levels	£1.32	-£2.01	-£0.02

APPENDIX 2

TREASURY MANAGEMENT STRATEGY 2008/09 – 20010/11

1. INTRODUCTION

The importance of the treasury management service has increased as a result of the freedoms provided by the Prudential Code.

This Treasury Management Strategy covers the Council's borrowing and investment activities and the effective management of associated risks.

Treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management). This Council adopted the Code of Practice on Treasury Management and the Treasury Management Policy Statement on 25 February 2002.

The Treasury Management Policy requires an annual strategy to be reported to Cabinet outlining the expected treasury activity for the forthcoming 3 years. A further report is produced after the year-end to report on actual activity for the year.

A key requirement of this strategy report is to explain both the risks, and the management of the risks, associated with the treasury service. These risks are shown at paragraphs 2 and 3 below.

Whilst the prudential indicators in appendix 1 consider the affordability and impact of capital expenditure decisions, the treasury service covers the effective funding of these decisions. There are specific treasury prudential indicators included in this strategy that need approval.

2. TREASURY MANAGEMENT PRACTICE – credit and counterparty risk

2.1 The Office of the Deputy Prime Minister issued investment guidance on 12 March 2004. Together with the relaxation of borrowing controls under the Prudential Code, this guidance replaces the previous regulations.

2.2 The key intention of the investment guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield.

2.3 The prudential code requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes and includes the statement of Treasury Management Practices.

2.4 This Council adopted this code of practice on 25 February 2002 and will apply its principles to all investment activity. In accordance with the Prudential Code this part of the approved treasury management practices must be agreed prior to each financial year and amended if necessary.

2.5 Annual Investment Strategy

2.5.1 The key requirements of both the Code and the ODPM guidance are to set an annual investment strategy covering the identification and approval of the Investment Policy as follows:

- The strategy guidelines for decision making on investment decisions. See paragraph 2.6.1.
- Specified investments that the Council will use. - These are highly credit rated and highly liquid investments in sterling and with a maturity of no more than a year. See paragraph 3.4.2 below.
- Non-specified investments that the Council will use. - This identifies the greater risk implications of investments that are not so highly credit rated. It specifies the limits for which investments may be made with each counterparty at any time. See paragraph 3.4.3 below.

2.5.2 It should be noted that specified and non-specified investments are both approved under the new guidance and both should normally form part of a council's policy.

2.6. Investment Policy

The investment policy summarises the main aims and objectives if the investment function of the treasury management service. The policy proposed for the Council is:

2.6.1 Strategy Guidelines

The main principle governing the Council's investment criteria is the security and liquidity of its investments before yield. However, the yield or return on the investment will be a consideration subject to adequate security and liquidity. After this main principle the Council will ensure:

- It has sufficient liquidity in its investments. For this purpose it will set out the maximum periods for which funds may prudently be invested. See paragraph 3.6.3.
- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections at section 3.4 below.
- The Executive Director will maintain a counterparty list in compliance with these criteria and will revise the list as necessary for practical use. The current proposed criteria are shown in section 3.4 below for approval.

3. THE TREASURY MANAGEMENT STRATEGY

This strategy covers:

- The current treasury position
- The expected movement in interest rates
- The borrowing and debt strategy
- The investment strategy (in compliance with the ODPM guidance)
- The monitoring of investment counterparties
- Prudential indicators and limits on treasury activities
- The use of external fund managers
- The use of money brokers
- The use of Money Market Funds
- Performance indicators
- Local prudential indicators

3.1 The Current Treasury Position

The Council's treasury position is highlighted in the following table. This includes estimated levels of temporary borrowing and investments as well as long-term requirements.

	2006/07 Actual £m	2007/08 Forecast £m	2008/09 Estimate £m	2009/10 Estimate £m	2010/11 Estimate £m
External Debt					
Total Debt at 31 March	0.0	0.0	0.0	0.0	0.0
Annual Change in Debt	0.0	0.0	0.0	0.0	0.0
Investments					
Investments	-22.6	-17.6	-11.1	-9.1	-7.6
Annual change in investm'ts	0.0	5.0	6.5	2.0	1.5
Net Borrowing	**-22.6**	**-17.6**	**-11.1**	**-9.1**	**-7.6**

3.2 The Expected Movement in Interest Rates

Short Term Interest Rates –

3.2.1 While the December cut in the Bank Base Rate came as no great surprise to the financial markets it did reflect the Monetary Policy Committee's (MPC) growing unease about the state of the domestic economy.

3.2.2 The November Inflation Report highlighted the threat of a steep decline in economic activity in 2008. However, until then there had been few signals that this was the case. More recently, the economic data has been suggesting that the threat is present.

3.2.3 The cooling in the housing market has been noted for some time although it is only in the past few months that the two key indicators (the Nationwide & Halifax Indices) have moved down in unison. The deciding factors behind the MPC's decision were probably the November surveys of the manufacturing and service sectors.

3.2.4 These indicators pointed towards a marked deceleration in activity and may well have been interpreted by the MPC as a sign that the effects of the summer's credit squeeze are beginning to spread beyond the confines of the financial markets.

3.2.5 The squeeze on credit represents a sharp tightening of domestic monetary policy. It is likely to take some time to evaporate and suggests that consumers' expenditure, which has still to see the full effects of the adjustment of discounted, fixed-rate mortgages, will eventually contract markedly.

3.2.6 This, along with a slowing economy, is expected to reduce inflation pressures and ensure CPI growth reverts to the 2% central target rate over the medium term.

3.2.7 Nevertheless, the Bank of England notes that the risks to inflation remain. Many of the current pressures are externally generated (oil, food, commodity prices etc) and will not respond to UK interest rate policy.

3.2.8 It is hoped that the anticipated slowing in international activity reverses at least some of these inflationary trends. In the mean time the MPC is hoping that UK inflation does not rise and that a reduction in household spending prevents companies passing cost increases on to the consumer.

Longer Term Interest Rates –

3.2.9 Concerns about the health of the financial sector will continue for some time and this will maintain the downward pressure on interest rates in the short-term.

3.2.10 However, worries about inflation prospects in the medium to long term are expected to drive money market rates higher through 2008/09 and beyond.

Medium-Term Rate Forecasts – Annual Averages %

Year	Base Rate %	1 Year Money Market Rate %	5-year Gilt %	20-year Gilt %	50-year Gilt %
2006/07	4.8	5.3	4.9	4.4	4.0
2007/08	5.6	6.0	5.3	4.9	4.5
2008/09	4.8	4.7	4.7	4.8	4.6
2009/10	4.8	4.8	4.8	4.7	4.6
2010/11	5.0	5.3	4.9	4.8	4.8
2011/12	5.2	5.5	5.3	5.2	5.1

3.3 Borrowing and Debt Strategy 2008/09 – 2010/11

3.3.1 The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy.

3.3.2 Long-term fixed interest rates are expected to fall modestly and then rise in the medium term. Base rates are expected to reduce following the peak forecast in 2007/08 but then rise again in the medium term. It is likely that the most advantageous time to raise low coupon long-term loans has passed, but there will be opportunities to do so in the next few years.

3.3.3 The Executive Director, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above. This will include borrowing in advance for future years requirements.

3.3.4 The expected borrowing requirement is:

	2007/08 revised £000	2008/09 Estimate £000	2009/10 Estimate £000	2010/11 Estimate £000
To fund Capital expenditure	3,148	2,382	1,755	2,132
Prior years expenditure not yet funded	4,719	6,721	7,601	7,428
Less MRP	-1,146	-1,502	-1,928	-2,112
Total Borrowing Requirement at year end	6,721	7,601	7,428	7,448

3.3.5 This table reflects the estimated loan financing shown at table 1.4 in appendix 1.

3.3.6 Although the borrowing requirement is detailed by year it is not certain that any loans will be raised as the Members wish to maintain “debt free” status currently.

3.4 Investment Strategy 2008/09 – 2010/11

3.4.1 The main principle governing the Council’s investment criteria is the security of its investments. However, the amount of interest earned on investments is a key consideration. After this main principle the Council will ensure:

- That it has sufficient liquidity in its investments. For this purpose it will set out the maximum periods for which funds may prudently be invested. See paragraph 3.6.3.

- That it maintains a policy for the categories of investment it will invest in and for choosing investment counterparties with adequate security. This is set out in the Specified and Non-Specified investment sections below.

3.4.2 Specified Investments

These investments are made in sterling and have duration of 1 year or less. They can be for a longer period but the council will have the right to be repaid within 12 months if it wishes.

These are low risk investments where the possibility of loss of principal or investment income is very low. Specified investments include:

- UK Government - (including gilts and the DMO)
- Local Authorities, Parish Councils etc
- Supranational Bonds
- Banks and Building Societies – which have at least the following short – term credit ratings

Credit Rating Agency	Short – Term Credit Rating
Fitch	F1 or F1+
Moody's	P – 1
Standard & Poors	A – 1 or A – 1+

- Money Market Funds – highly rated by a credit rating agency

3.4.3 Non-Specified Investments

Non – Specified investments are any other type of permissible investment not defined as specified above and include:

- UK Government Gilts with a maturity of greater than 1 year.
- Local Authorities, Parish Council etc with a maturity of greater than 1 year.
- Supranational bonds – with a maturity date beyond 1 year.
- Institutions not meeting the credit rating at 3.4.2 above and where other restrictions have been applied.

Counterparty Criteria	Investment Restrictions
Unrated fully owned subsidiaries of highly credit rated institutions	£3m for up to 6 months
Unrated Building Societies with total assets greater than £500 billion.	£5 million for up to 6 months
Unrated Building Societies with total assets greater than £250 billion but less than £500 billion	£3m for up to 3 months
Local Authorities	£5m for up to 4 years
Organisations wholly owned by UK Government, e.g. Royal Mail Holdings PLC	£3m for up to 6 months

- Banks and Building Societies – with a high credit rating but with a maturity of more than 1 year as follows:

Long-Term Credit Rating	Maximum Period of Investment
A (+/-)	Up to 2 years
AA (+/-)	Up to 4 years
AAA (+/-)	Up to 5 years

3.4.4 The longer-term investments will also need to fit in with the principles of the treasury prudential indicator for total sums invested for periods longer than 364 days as shown at 3.6.3 below.

3.4.5 The Council will ensure that no more than 20% of the current total sum invested may be deposited with any one organisation at any one time at the time of investment. But if the total sum invested is less than £2.5m, then the maximum investment may be £500,000.

3.4.6 In the normal course of the Council's cash flow operations it is expected that both specified and non-specified investments will be used as both categories allow for short-term investments.

3.4.7 The use of longer-term investments will be within the non-specified investment category. These investments will only be used according to the parameters shown at 3.6.3 below and will depend on the council's need for liquidity.

3.4.8 Investment Strategy 2008/09

Expectations on shorter-term interest rates, on which investment decisions are based, show a likelihood of the current 5.50% Bank Base Rate reducing in early 2008. The Council's investment decisions are based on comparisons between the rises priced into market rates against the Council's and advisers own forecasts. It is likely that investment decisions will be made for longer periods with fixed investments rates to lock in good value and security of return if opportunities arise, subject to over riding credit counterparty security. The Executive Director, under delegated powers, will undertake the most appropriate form of investments depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast at 3.2.10 above.

3.4.9 Sensitivity to Interest Rate Movements

Future Council accounts will be required to disclose the impact of risks on the Council's treasury management activity. Whilst most of the risks facing the treasury management service are addressed elsewhere in this report (credit risk, liquidity risk, market risk, maturity profile risk), the impact of interest rate risk is not quantified. The table below highlights the estimated impact of a 1% increase/decrease in all interest rates to treasury management costs/income for next year.

Revenue Budgets	2008/09 Estimated £000	2008/09 Estimated + 1% £000	2008/09 Estimated -1% £000
Interest on Borrowing	40	48	32
Investment income	1,471	1,751	1,191

3.5 The Monitoring of Investment Counterparties

3.5.1 The credit rating of counterparties will be monitored regularly, as a policy at least monthly. However the Council receives credit rating advice from its advisers, on a daily basis as and when ratings change, and counterparties are checked promptly.

3.5.2 There will be a minor time delay between rating changes and the Council receiving notification, and on occasion ratings may be downgraded when an investment has already been made.

3.5.3 The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list. And if required new counterparties which meet the criteria will be added to the list.

3.6 Treasury Management Prudential Indicators and Limits on Activity.

3.6.1 There are further treasury prudential indicators. The purpose of these prudential indicators is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if the limits are set at a level that are too restrictive they will actually reduce opportunities to reduce costs.

3.6.2 The indicators for borrowing are:

- Upper limits on fixed rate exposure –
  This indicator identifies a maximum limit for fixed interest rates based upon the debt position net of investments.

- Upper limits on variable rate exposure –
  Similar to the previous indicator this covers a maximum limit on variable interest rates. The variable limit is 50% of the total net borrowing to ensure that volatility is contained within the portfolio.

  The following table shows the estimated limits for the net debt position: -

Net Debt Limits	2008/09 Upper	2009/10 Upper	2010/11 Upper
Limit for fixed interest rates based on net debt	100%	100%	100%
Limit for variable interest rates based on net debt	50%	50%	50%

- Maturity structure of borrowing –
  These limits are set to heighten the awareness of borrowing fixed interest rate loans for varying periods and to reduce the council's exposure to the refinancing of the loans when maturity is reached. Each limit for

fixed interest rates has been set at 100% because only limited borrowing is envisaged at this time. If a loan is raised for any purpose it would, by its very nature, fall into one of the periods and not be spread over a range of periods. The limits are required for both upper and lower thresholds.

A variable interest rate limit has been introduced to help identify the risks associated with fixed/variable interest rate borrowing. This is set at 50% to ensure that the volatility of the portfolio is limited.

These limits are shown in the following table:

Borrowing	**2008/09 Upper**		**2009/10 Upper**		**2010/11 Upper**	
Limits - fixed interest rates	100%		100%		100%	
Limits - variable interest rates	50%		50%		50%	
Maturity Structure of fixed interest rate borrowing						
	Lower	**Upper**	**Lower**	**Upper**	**Lower**	**Upper**
Under 12 months	0%	100%	0%	100%	0%	100%
12 months to 2 years	0%	100%	0%	100%	0%	100%
2 years to 5 years	0%	100%	0%	100%	0%	100%
5 years to 10 years	0%	100%	0%	100%	0%	100%
10 years and above	0%	100%	0%	100%	0%	100%

3.6.3 The limits for investment are:

- Estimated interest receivable on net investments-
  The limits on fixed and variable interest rates give an indication of the potential volatility of the interest earnings.

- Maximum principal funds invested –
  These limits are set to help identify the total sums available for investment over the year.

- Total principal funds invested for more than 364 days –
  These limits are set to reduce the need for early sale of an investment, and are based on the availability of investments after each year-end. This is the amount of funds that are not needed immediately for revenue or capital purposes and therefore can be invested for longer periods.

- Fixed and variable interest rate investments –
  Limits are included for fixed and variable interest rate investments to contain the volatility of the investments

- Maturity structure of investments –
  These limits are set to indicate the maturity structure of investments and to ensure that Councils with large volumes of investments that are not immediately required for expenditure purposes, and therefore

invested for periods longer than 364 days, are invested in a cautious manner. The lower limit is set at 25% for less than 12 months, as a greater proportion of this Council's funds will not be available for longer-term investment. The upper limits are all set at 100% because only a limited value of funds will fall into this category.

These limits are shown in the following table: -

Investments	**2008/09 Upper**		**2009/10 Upper**		**2010/11 Upper**	
Estimated interest on net investments	£1.431m		£1.296m		£1.396m	
Estimated Maximum sums invested	£42m		£37m		£38m	
Estimated Maximum sums invested for more than 364 days	£5.5m		£4.5m		£3.5m	
Limits - fixed interest rates	100%		100%		100%	
Limits - variable interest rates	50%		50%		50%	
Maturity Structure of investments						
	Lower	**Upper**	**Lower**	**Upper**	**Lower**	**Upper**
Under 12 months	25%	100%	50%	100%	25%	100%
12 months to 2 years	0%	75%	0%	75%	0%	75%
2 years to 5 years	0%	75%	0%	75%	0%	75%

3.7 USE OF EXTERNAL FUND MANAGERS

3.7.1 The Council withdrew all funds from fund managers in April 2006 following four years of disappointing returns.

3.7.2 Prudential Indicators for fund managers are no longer required to be set for this Council.

3.7.3 Prudential Indicators will be reintroduced if it is deemed beneficial to the Council to use fund managers again in the future.

3.8 USE OF MONEY BROKERS

3.8.1 Generally the Council will use money brokers to place investments with counterparties. The broker has access to the money markets and will be able to determine the best rate of investment for the Council given the counterparties that the Council can invest with and type of investment required.

3.8.2 Several highly rated organisations now conduct their own treasury transactions and no longer use money brokers. If beneficial to the Council, investments may be made by dealing directly with these counterparties.

3.9 USE OF MONEY MARKET FUNDS

3.9.1 Money Market Funds are managed by external banking organisations.

3.9.2 Funds are invested in a basket of approved investment products and across a variety of counterparties.

3.9.3 These funds are highly credit rated and under particular market conditions can produce a return in excess of the benchmark used by the Council.

3.9.4 Although the Council has not used money market funds as an investment vehicle in the past it may be beneficial to do so in the future.

3.10 PERFORMANCE INDICATORS

3.10.1 The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. An example of performance indicators often used for the treasury function are:

- Investments – In-house fund returns should be above the average 7 day LIBID rate

3.10.2 The result of this indicator will be reported in the Annual Treasury Report at each year-end.

3.11 LOCAL PRUDENTIAL INDICATORS

There are no local prudential indicators other than those currently included in the body of this report.