APPENDIX 1

TREASURY MANAGEMENT STRATEGY – 2009/2010

Treasury Limits for 2009/10 to 2011/12

It is a statutory duty under s.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. This amount is termed the 'Affordable Borrowing Limit'.

The Council must have regard to the Prudential Code when setting the Affordable Borrowing Limit. The Code requires an authority to ensure that its total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax levels is 'acceptable'.

The Affordable Borrowing Limit must include all planned capital investment to be financed by external borrowing and any other forms of liability, such as credit arrangements. The Affordable Borrowing Limit is to be set on a rolling basis for the forthcoming year and two successive financial years.

Prudential Indicators for 2009/10 – 2011/12

The following prudential indicators are relevant for the purposes of setting an integrated treasury management strategy.

The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This was adopted in January 2002 by full Council.

Table 1: Prudential Indicators for 2009/10 – 2011/12

PRUDENTIAL INDICATOR	2007/08 Actual	2008/09 Probable Outturn	2009/10	2010/11	2011/12
Current Financial Plan Data	£'000	£'000	£'000	£'000	£'000
Estimate of Capital Expenditure					
This is the estimates of capital expenditure for the current and future years as per the Councils' Financial Plan.	72,907	75,621	91,304	70,889	50,099
Net Increase in council tax (band D per annum) Figures in £'s (not £'000's)					
The estimate of incremental impact of capital investment decisions proposed in this budget report, related to the added borrowing requirement.			£0.00	£0.00	£1.26
Cumulative totals:			£0.00	£0.00	£1.26
Capital Financing as % of Net Revenue Stream					
Estimates for net revenue stream for current and future years based on estimates of the amounts to be met from government grants and local taxpayers.	4.90%	4.28%	5.99%	6.60%	7.03%
Capital Financing Requirement (as at 31 March)					
The capital financing requirement measures the authority's underlying need to borrow for a capital purpose.	83,049	96,917	132,351	140,436	148,127

PRUDENTIAL INDICATOR	2007/08	2008/09	2009/10	2010/11	2011/12
Treasury Management Indicators	£'000	£'000	£'000	£'000	£'000
Authorised limit for external debt					
These limits include current commitments and proposals in the budget report for capital expenditure, plus additional headroom over & above the operational limit for unusual cash movements. The lower borrowing levels compared to the Capital Financing Requirement represents the proposed use of internal balances given the low interest rates obtained on investments.					
borrowing	108,000	105,000	85,000	108,000	123,000
Other long term liabilities	2,000	2,000	2,000	2,000	2,000
Cumulative Total	**110,000**	**107,000**	**87,000**	**110,000**	**125,000**
Operational limit for external debt					
The operational boundary for external debt is based on the same estimates as the authorised limit but without the additional headroom for unusual cash movements.					
borrowing	103,000	100,000	80,000	103,000	118,000
other long term liabilities	2,000	2,000	2,000	2,000	2,000
Cumulative Total	**105,000**	**102,000**	**82,000**	**105,000**	**120,000**
Upper limit for fixed interest rate exposure					
This is the maximum % of total borrowing which can be at fixed interest rate.	100%	100%	100%	100%	100%
Upper limit for variable interest rate exposure					
While fixed rate borrowing contributes significantly to reducing uncertainty surrounding interest rate changes, the pursuit of optimum performance levels may justify keeping a degree of flexibility through the use of variable interest rates.					
This is the maximum % of total borrowing which can be at variable interest rates.	50%	50%	50%	50%	50%
Upper limit for total principal sums invested for over 364 days					
Given the Councils' financial position, i.e. of having low cash balances, any lending is likely to be the result of the phasing of cash flow. Investment periods are unlikely to be more than 12 months (although the position could change if the Council generated significant receipts pending review of its asset base)					
The maximum % of total investments which can be over 364 days.	80%	80%	80%	80%	80%

Maturity Structure of new fixed rate borrowing during 2009/10	Upper limit	Lower limit
Under 12 months	100%	NIL
12 months and within 24 months	100%	NIL
24 months and within 5 years	100%	NIL
5 years and within 10 years	100%	NIL
10 years and above	100%	NIL

Current Portfolio Position

The Council's treasury portfolio position at 31st December 2008 comprised:

	Principal	**Ave. rate**
	£m	%
Total Fixed rate funding	PWLB 60	4.22
Variable rate funding	Market 20	4.50*
Other long term liabilities	Nil	N/A
TOTAL DEBT	**80**	**4.29**
TOTAL INVESTMENTS**	**104.4**	**3.82**

* The market loans are 'lenders options' or LOBO's. These are fixed at a relatively low rate of interest for an initial period but then revert to a higher rate of 4.5%. When the initial period is over the loans are then classed as variable, as the lender has the option to change the interest rate at 6 monthly intervals, however at this point the borrower has the option to repay the loan without penalty.

** Total Investments includes Schools balances where schools have not opted for an external bank account and cash balances related to the Avon Pension Fund, PCT Pooled budgets and West of England Growth Points funding.

Borrowing Requirement

	2007/08 Actual	2008/09 Probable Outturn	2009/10 Estimate	2010/11 Estimate	2011/12 Estimate
	£'000	£'000	£'000	£'000	£'000
New borrowing	0	0	0	23,000	15,000
Alternative financing arrangements	0	0	0	0	0
Replacement borrowing	0	0	0	0	0
TOTAL New Borrowing	**0**	**0**	**0**	**23,000**	**15,000**
Cumulative Council Borrowing	**80,000**	**80,000**	**80,000**	**103,000**	**118,000**

Prospects for Interest Rates

The Council has appointed Sterling Treasury Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Appendix 3 gives their view on prospects for interest rates in 2009/10. The following table gives this view as at 9th January 2009:

Sterling interest rate forecast – 9th January 2009

	Bank Rate	1 month LIBOR	3 month LIBOR	12 month LIBOR	25 year PWLB	50 year PWLB
Current	1.50	1.77	2.38	2.71	4.23	4.12
Q1 2009	1.00	1.20	1.70	1.90	4.20	4.10
Q2 2009	1.00	1.20	1.60	1.80	4.50	4.30
Q3 2009	1.00	1.10	1.50	1.70	4.70	4.50
Q4 2009	1.00	1.10	1.50	1.70	4.80	4.50
H1 2010	1.50	1.75	2.00	2.50	4.90	4.60
H2 2010	2.00	2.35	2.75	3.10	5.20	4.90
H1 2011	3.50	3.80	4.25	4.75	5.50	5.20
H2 2011	5.00	5.10	5.25	5.40	5.70	5.40

Sterling's current interest rate view is that Bank Rate: -

- Drop to 1.0% in the first quarter of 2009 then remain there for one year, then increase by 0.5% each half during 2010 & then increase by 1.5% per half in 2011.
- There is an extensive downside risk to this forecast that the MPC may decide to make further cuts in Bank Rate due to the risk of continual economic deterioration.

The Council has budgeted for interest rates at 1.0% for 2009/10, 2.0% for 2010/11 & 3.0% thereafter. This is compared to Sterling's view of 1.1%, 2.3% & 4.6% for each year respectively, reflecting the downside risk.

Borrowing Strategy

Sterling Consultancy expects longer-term gilt yields and so PWLB rates to rise throughout 2009 as the market starts to consider economic recovery and the UK government issues more debt to finance its fiscal stimulus and bank bailout. Therefore the long-term risks for borrowing rates are to the upside owing to proposed increase in levels of government borrowing over the next 5 years, but in the short-term the risks remain to the downside for the UK's economic performance, which could weigh on the gilt market particularly during the first half of the year.

This would necessitate the council considering funding options early in order to take advantage of current low interest rates, but following concerns regarding elevated levels of credit risk and in light of the Council's cash balances, the more likely decision is to use internal resources rather than external borrowing to finance capital spending in 2009. This would reduce the council's investment balance and so the amounts it lends on the money markets to financial institutions.

If the council were to consider external borrowing to fund capital expenditure, consideration will be given to either short-term or variable rate options in order to take advantage of low interest rates, with a view to switching to long-term fixed rate debt at an appropriate time.

Against this background caution will be adopted with the 2009/10 treasury operations. Officers will monitor the interest rate market and adopt a pragmatic approach to changing circumstances.

Debt Rescheduling and Early Repayment

With the help of its treasury advisors the council will actively consider debt restructuring as a way to reduce risk, reduce average debt costs and perhaps create short-term savings. Making savings through debt restructuring has become more difficult following the PWLB's introduction of a separate repayment rate in 2007, but opportunities can still arise in favourable market conditions.

As investment rates are low and are due to fall further, there are opportunities to make savings and reduce risk in the short term by the straight repayment of debt. This can offset the fall in investment income and will reduce credit risk in the investment portfolio.

All rescheduling will be reported in the next available Treasury Management Monitoring report following its action.

Minimum Revenue Provision (MRP) & Depreciation Policy

The Council is require to make revenue provision to repay capital spend that is financed by borrowing (either supported or unsupported). This is called the Minimum Revenue Provision (MRP). The Department of Communities & Local Government has issued regulations that require full Council to approve a MRP & Depreciation Policy in advance each year. The Council is recommended to approve the following statement which is unchanged from that agreed in 2008/09:

Council MRP Policy

Bath and North East Somerset will make a prudent minimum revenue provision for all new unsupported borrowing from 1st April 2008.

For all Government Supported Borrowing

a) The Council will determine that its MRP is equal as the amount determined in accordance with the former regulations 28 and 29 of the 2003 Regulations, as if they had not been revoked by the 2008 regulations.

For all new schemes of Council supported borrowing after 1st April 2008 it will use the Asset Life Method

b) This will be calculated where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, MRP is to be made in equal annual instalments over the life of the asset, in accordance with the following formula:

$$\frac{A - B}{C}$$

Where-

A is the amount of the capital expenditure in respect of the asset financed by borrowing or credit arrangements

B is the total provision made before the current financial year in respect of that expenditure

C is the inclusive number of financial years from the current year to that in which the estimated life of the asset expires.

c) Subject to paragraph f below, MRP will normally commence in the financial year following the one in which the expenditure was incurred.

d) Asset life. The estimated life of the asset will be determined in the year that MRP commences and not subsequently be revised.

e) Freehold land. If no life can reasonably be attributed to an asset, such as freehold land, the life will be taken to be a maximum of 50 years. However, in the case of freehold land on which a building or other structure is constructed, the life of the land will be treated as equal to that of the structure, where this would exceed 50 years.

f) Construction period. When borrowing to construct an asset, the authority will treat the asset life as commencing in the year in which the asset first becomes operational. It may accordingly postpone beginning to make MRP until that year. “Operational” here has its standard accounting definition. Investment properties will be regarded as becoming operational when they begin to generate revenues.