Agenda Item

Report to:	**Cabinet**
Date:	**26 January 2012**
By:	**Director of Corporate Resources**
Title of report:	**Treasury Management Strategy for 2012/13**
Purpose of report:	**To determine the County Council's Authorised Limit for borrowing, adopt the prudential indicators and limits, to approve the Minimum Revenue Provision (MRP) Statement and to approve the treasury management strategy and policy statement for 2012/13.**

RECOMMENDATIONS

The Cabinet is recommended to recommend the County Council to:

(i) determine that for 2012/13 the Authorised Limit for borrowing shall be £394m;

(ii) adopt the prudential indicators as set out in paragraph 5 of the attached appendix;

(iii) approve the Minimum Revenue Provision (MRP) Statement for 2012/13 as set out in paragraph 6 of the attached appendix; and

(iv) approve the treasury management strategy and policy statement for 2012/13 as set out in paragraph 8 of the attached appendix.

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1. Financial Appraisal

1.1 This report contains recommendations about the borrowing limits, the prudential indicators and limits, and the strategy and policy. No changes from the updated prudent strategy and policy for the current year (agreed by the cabinet in November 2011) are recommended for 2012/13. The remaining recommendations are required to meet legislative requirements for setting limits and publishing prudential indicators.

1.2 The emphasis will continue on security (protection of the capital sum invested) and liquidity (keeping money readily available for expenditure when needed) rather than yield. The strategy and limits are consistent with the proposed capital programme and revenue budget dealt with elsewhere on the agenda. The strategy aims to secure investment income of at least base rate plus 0.5% on the Council's general cash balances. As will be clear from the events globally and nationally since 2008, it is impossible in practical terms to eliminate all credit risk. This Council seeks to be as prudent as possible.

1.3 Whilst the Council is recommended to approve increased borrowing limits to finance the capital programme in reality, no new external borrowing is being undertaken and existing cash balances are being used for "internal borrowing" to finance the programme.

2. Supporting Information

2.1 East Sussex County Council defines its treasury management activities as the management of the organisation's cash flows, its banking, money market and capital market transactions, the effective management of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

2.2 Under Section 3 (1) of the Local Government Act 2003 and the Prudential Code for Capital Finance 2004, the County Council is required to determine its authorised borrowing limit, to adopt treasury management prudential indicators and limits and to agree its treasury management strategy and policy statement.

2.3 The key driver remains the prudent approach to Treasury Management taken by this authority and an investment emphasis on security and liquidity. The aim is to receive an investment income on general balances of at least base rate plus 0.4% whilst ensuring, so far as possible in the current climate, the security of principal and the minimisation of potential risk exposure.

The list of organisations used for investment

2.4 It is necessary to continually review the list of approved organisations used and amounts lent to organisations for investment of surpluses. No new changes are proposed to the list of approved organisations used for investment of short term surpluses which was updated in November for 2011/12. The list for 2012/13 is set out in the Appendix (paragraph 3.6).

Current risks and their management

2.5 The situation on the investment of surplus funds changed substantially at the beginning of 2008 and has been constantly changing since then. This Council has always adopted a prudent approach on its investment strategy and in the last few years, there have been regular changes to the list of the approved organisations used for investment of short term surpluses. This list is regularly reviewed to ensure that the Council is able to invest in the best available rates consistent with low risk; the organisations are regularly monitored to ensure that their financial strength and low risk has been maintained. When the original strategy for 2011/12 was agreed in January 2011, the money markets were still volatile with Banks reluctant to lend to each other. In this climate ensuring the security of investments continues to be difficult and extreme caution taken on where surplus funds can be invested. The agreed strategy continued the prudent approach and ensured that all investments were only to the highest quality rated banks and only up to a period of one year. Changes to the strategy for 2011/12 have been made and reported to Cabinet on 15 November. The amendments reflect the uncertainties in the market. The strategy for 2012/13 (unchanged from the revised policy for 2011/12) continues the prudent approach to Treasury Management.

Operational Boundary and Authorised Limit for borrowing

2.6 The background information and the calculation of the limits for 2012/13 of £374m (Operational Boundary) and £394m (Authorised Limit) are set out in the attached appendix (paragraph 4).

Prudential indicators and Treasury Management indicators

2.7 These are self-imposed indicators that are set on an annual basis (paragraph 5).

Capital Financing Requirement and Minimum Revenue Provision statement

2.8 This is set out in paragraph 6 of the appendix to comply with best practice.

Treasury management strategy and policy statement for 2012/13

2.9 The policy statement remains unchanged from the current year and is set out in paragraph 8 of the attached appendix.

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BACKGROUND DOCUMENTS
Cabinet 25 January 2011 Treasury Management Strategy for 2011/12
5 July 2011 Treasury Management Stewardship Report 2010/11
15 November 2011 Half year review and amendment to our Strategy
Audit, Best Value and Community Safety Scrutiny Committee 1 September 2011 Stewardship Report 2010/11
CIPFA Prudential Code
CIPFA Treasury Management in the Public Services- Code of practice
Local Government Act 2003 Local Government Investments –Guidance from the former Office of the Deputy Prime Minister

Appendix to Cabinet Report - Treasury Management Strategy for 2012/13

1. Background information

1.1 Cabinet receive an annual Treasury Management Strategy report, normally in January or February, which sets out the proposed strategy for the year ahead. This strategy includes the limits and criteria for organisations to be used for the investment of cash surpluses and has to be approved by the County Council.

1.2 This Council has always adopted a prudent approach on its investment strategy and in the last few years, there have been regular changes to the list of the approved organisations used for investment of short term surpluses. This list is regularly reviewed to ensure that the Council is able to invest in the best available rates consistent with low risk; the organisations are regularly monitored to ensure that their financial strength and low risk has been maintained.

<u>Original Strategy agreed for 2011/12</u>

1.3 The strategy ensured that in the current economic climate a prudent approach was maintained. This would be achieved through investing with selected banks and funds which meet the Council's rating criteria. The emphasis would continue on security (protection of the capital sum invested) and liquidity (keeping money readily available for expenditure when needed) rather than yield. The strategy continued with this prudent approach and no change was proposed to change the period of investment from up to a year. There was no change to the list of counterparties or the limit of the investment which remained at a maximum of £60m.

1.4 Opportunities for cost effective repayment of existing debt and restructuring opportunities were to be constantly monitored and would be taken if and when they emerge.

1.5 Our policy gave some flexibility to borrow up to £16m in advance of future need. However, given the current interest climate, no external borrowing and certainly none in advance, was planned.

1.6 The funds of the Fire Authority would continue to be invested in line with their own specific policy.

1.7 The County Council funds would be invested as follows:-

<u>Up to a maximum of £60m deposited up to a period of up to one year</u> with any of the following: -

Bank / Fund
Barclays Lloyds/HBOS Nat West/RBS Santander UK HSBC Nationwide Individual Treasury Type Money Market Funds (AAA rated) Individual Cash Type Money Market Funds (AAA rated)

Only banks which are eligible for the Government's Credit Guarantee Scheme AND meet the following minimum rating criteria for at least two of the designated agencies to be used.

Ratings Agency	**Long Term**	**Short Term**
Fitch	AA-	F1+
Moody	AA3	P-1
Standards and Poors	AA-	A-1+

The policy retained the ability to revert to some, or even extensive use of the Government's Debt Management Account Deposit Facility (DMADF) if market risk conditions tighten.

1.8 The strategy going forward would continue with the policy of ensuring minimum risk but would also need to deliver secure investment income of at least bank rate on the Council's cash balances. (The actual target was bank rate plus 0.5%).

1.9 Additional requirements under the Code of Practice required the Council to supplement credit rating information. Whilst the above criteria relied primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information had been and would continue to be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Sovereign ratings, Credit Default Swaps, equity prices, the Sector security and liquidity model and the CIPFA National treasury risk model as well as media updates etc.) would be assessed when comparing the relative security of differing investment counterparties.

Amendment and Revised Strategy agreed for 2011/12

1.10 Our Treasury Management Policy recognises that movements within the money markets can happen with no notice and the Director of Corporate Resources would have to amend this strategy in order to safeguard Council funds.

1.11 Although our Strategy allowed for investments up to one year, the continuing uncertainties in the markets dictated that we continued with a mainly overnight (on call) policy with some small investments amount in percentage terms of three month investments. In the summer of 2011 we switched to a complete on call policy and by mid September all of our investments could be returned within a working day.

1.12 In October, the ratings agency Moody's reduced the credit ratings of twelve UK financial institutions including NatWest/RBS, Lloyds / HBOS and Santander UK. Later in the same month, the ratings agency Fitch reduced the credit ratings of two UK financial institutions NatWest/RBS and Lloyds / HBOS. These rating agency reviews were part of a previously announced (May 2011) reassessment of the likely level of systemic (Government) support these institutions would get IF they were to get into financial difficulty in the future. It was reported that the resultant downgrading should not necessarily be construed that these institutions were experiencing difficulty that would result in a default.

1.13 The consequence of the bank downgrades meant we were operating outside our normal rating criteria with two banks i.e. ~ NatWest/RBS and Lloyds/HBOS ~ which fall below our minimum rating agency thresholds but within overall policy because the Director of Corporate Resources has discretion.

1.14 We continued to invest in both Nat West/RBS and Lloyds/HBOS because

- The high level of Government Ownership of NatWest./RBS is (83%) and Lloyds HBOS (40.2%)
- UK Sovereign rating remains at AAA.
- We have an overnight policy and monies can be withdrawn without notice.
- Nat West/RBS is the County Council's banker.

1.15 The changes above required the Strategy for 2011/12 (set out in Paragraphs 1.3 to 1.9 of this Appendix) to be amended to continue with the prime objective of the effective management of risk and following our prudent policy.

1.16 The policy for 2011/12 was amended with the County Council funds to be invested as follows:-

(A) UK Investment Without Government Equity Holding

Up to a maximum of £60m deposited up to a period of up to one year with any of the following: -

The current policy stance is overnight but the policy allows changes to reflect market conditions if and when they improve.

Bank / Fund / Local Authority
Barclays Santander UK HSBC Nationwide Individual Treasury Type Money Market Funds (AAA rated) which invest in Government Securities only Individual Cash Type Money Market Funds (AAA rated) Another Local Authority (Equivalent to the low risk of investing with the Government but not formally rated)

Only banks which meet the following minimum rating criteria for at least two of the designated agencies to be used.

Ratings Agency	Long Term	Short Term
Fitch	AA-	F1+
Moody	AA3	P-1
Standards and Poors	AA-	A-1+

(B) UK Investment With Government Equity Holding of minimum of 30%

We are taking 30% as a minimum level of significant associated company influence. In practice it serves as a trigger to formally review our position.

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Up to a maximum of £60m deposited up to a period of up to three months with the following: -

The current policy stance is overnight but the policy allows changes to reflect market conditions if and when they improve.

Bank
Lloyds/HBOS Nat West/RBS

Only banks which meet the following minimum rating criteria for at least two of the designated agencies are to be used. The banks will not be used if the UK Sovereign rating falls below AAA.

Ratings Agency	Long Term	Short Term
Fitch	A	F1
Moody	A2	P-1
Standards and Poors	A	A-1

The policy retains the ability to revert to some, or even extensive use of the Government's Debt Management Account Deposit Facility (DMADF) if market risk conditions tighten.

1.17 In addition to the Credit Ratings Agencies, various methods have and will be used to monitor the Banks and Funds and these are set out in paragraph 1.9. Other very safe alternative investments will be explored when they become available.

1.18 The changes in our policy can be summarised as follows:-

- The new policy splits the investments into two groups,
  (A) UK Investment Without Government Equity Holding and
  (B) UK Investment With Government Equity Holding of a minimum of 30%

UK Investment Without Government Equity Holding

- The reference to the Government's Credit Guarantee Scheme has been deleted as it is not now relevant.
- Investments can be made to other Local Authorities. (Equivalent to the low risk of investing with the Government but not formally rated)
- The policy would allow investments up to one year but would only be used if market conditions improve. The current policy is overnight only.

UK Investment With Government Equity Holding of a minimum of 30%

- Lloyds/HBOS and Nat West/RBS included within UK Investment With Government Equity Holding of over 30%
- The investment allowed up to three months but the current policy is overnight and allows changes to reflect market conditions if and when they improve.
- New lower ratings criteria but the banks will not be used if the UK Sovereign rating falls below AAA.

It was continued to be recognised that movements within the money markets can happen with no notice and the Director of Corporate Resources would have to amend this strategy in order to safeguard Council funds. As in the past any such actions would be reported to the next Cabinet meeting.

2 Formulating a Strategy for 2012/13

<u>The treasury management activity during 2011/12 to date</u>

<u>Borrowing</u>

2.1 The County Council's past strategy was to borrow to support the Capital Programme and lend out other cash (rather than using internal borrowing). Historically this meant that the interest rate earned on cash balances was higher than the interest rate paid on loans from the Public Works Loans Board (PWLB). In the current financial climate, this interest rate differential has been removed. No new PWLB borrowing has taken place since January 2008 and is unlikely in the current climate unless long term PWLB rates reach a very low level (where the long term benefit would exceed the short term costs).

2.2 As well as using the existing cash balances to finance capital spending (rather than new borrowing), a restructure of our debt was undertaken in February 2010 where £23m of PWLB loans at a rate of 4.7% was repaid and will be replaced in February 2012 with market loans of £23m at rate of 4.39%. The repayments of PWLB loans and the replacement with market loans in two years time will result in a total savings of £1,149,153 over the first seven years after taking into account a premium payment made to the PWLB for compensation for an early repayment of loans. This was reported in the Stewardship report to Cabinet in June 2010.

2.3 The average interest rate of all debt at 31 March 2011 (£241.2m) was 5.31% and at 31 March 2012 (£264.2m) will be 5.20% as long as no new loans are taken and no beneficial rescheduling of debt is available.

2.4 Our opportunity to restructure our debt has been significantly reduced since October 2010 as a result of the PWLB increasing all of its lending rates by 1% but it did not increase the rate of interest used for repaying debt.

Investment

2.5 Base interest rate has stayed at 0.5% in 2011/12 to date. The rate is the lowest ever rate and the rate has remained unchanged for the longest period on record.

2.6 There have been continued uncertainties in the markets during the year to date. There was a financial crisis in the euro-zone, triggered by the threat of a sovereign debt default by Greece. The sovereign ratings of certain European countries (Spain, Portugal and Greece) were downgraded in the first two months and although our policy does not allow us to invest with their banks, these concerns affect the counterparties used within our strategy.

2.7 Credit ratings have been used to monitor the banks used under our strategy as well as additional market information such as Credit Default Swaps, equity prices, sovereign ratings as well information through the media.

2.8 The strategy for 2011/12, agreed in January 2011, continued the prudent approach and ensured that all investments were only to the highest quality rated banks and only up to a period of one year. The changes to this Strategy have been made (see Paragraphs 1.9 to 1.17) because of the continued uncertainties in the market.

2.9 Since the amendment to the strategy in November, investments to two banks on our lending list have been withdrawn as a result of falling below our set criteria. All of our investments continue to be on call (overnight only).

Comment from Sector (our Treasury advisors) on the outlook for 2012/13

2.10 Economic forecasting remains troublesome with so many extermal influences weighing on the UK. There does, however, appear to be consensus among analysts that the economy remains weak and whilst there is still a broad range of views as to potential performance, they have all been downgraded throughout 2011. Key areas of uncertainty include:

- a worsening of the Eurozone debt crisis and heightened risk of the breakdown of the bloc or even of the currency itself;
- the impact of the Eurozone crisis on financial markets and the banking sector;
- the impact of the Government's austerity plan on confidence and growth and the need to rebalance the economy from services to exporting manufactured goods;
- the under-performance of the UK economy which could undermine the Government's policies that have been based upon levels of growth that inceasingly seem likely to be undershot;
- a continuation of high levels of inflation ;
- the economic performance of the UK's trading partners, in particular the EU and US, with some analysts suggesting that recession could return to both;
- stimulus packages failing to stimulate growth;
- elections due in the US, Germany and France in 2012 or 2013;
- potential for protectionism i.e. an escalation of the currency war / trade dispute between the US and China.

2.11 The overall balance of risks remains weighted to the downside. Lack of economic growth, both domestically and overseas, will impact on confidence putting upward pressure on unemployment. It will also further knock levels of demand which will bring the threat of recession back into focus.

2.12 Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries.

2.13 Given the weak outlook for economic growth, Sector sees the prospects for any interest rate changes before mid-2013 as very limited. There is potential for the start of Bank Rate increases to be even further delayed if growth disappoints.

3 Proposed Strategy for 2012/13

3.1 In the current economic climate it is essential that a prudent approach is maintained. This will be achieved through investing with selected banks and funds which meet the Council's rating criteria. The emphasis will continue on security (protection of the capital sum invested) and liquidity (keeping money readily available for expenditure when needed) rather than yield. The strategy for 2012/13 must continue with this prudent approach and no changes are proposed to the revised strategy for 2011/12 agreed by Cabinet in November.

3.2 It is also important to recognise that movements within the money markets can happen with no notice and the Director of Corporate Resources may have to amend this strategy in order to safeguard Council funds. As in the past any such actions will be reported to the next Cabinet meeting.

3.3 It is not expected that any new external borrowing will be undertaken in the next 15 months however the limits set out in paragraph 4 would allow such borrowing. External borrowing will only take place if the rates available are so low that the long term benefits will significantly exceed the short term cost.

3.4 Opportunities for cost effective repayment of existing debt and restructuring opportunities are constantly monitored and will be taken if and when they emerge.

3.5 Our policy gives some flexibility to borrow up to £16m in advance of future need. The detail is set out in paragraphs 4.2 and in the table at 5.2. However, given the current interest climate, no external borrowing and certainly none in advance, is planned.

3.6 The County Council funds will be invested as follows (unchanged from the revised Strategy for the current year) :-

(A) UK Investment Without Government Equity Holding

<u>Up to a maximum of £60m deposited up to a period of up to one year</u> with any of the following: -

The current policy stance is overnight but the policy allows changes to reflect market conditions if and when they improve.

Bank / Fund / Local Authority
Barclays
Santander UK
HSBC
Nationwide
Individual Treasury Type Money Market Funds (AAA rated) which invest in Government Securities only
Individual Cash Type Money Market Funds (AAA rated)
Another Local Authority (Equivalent to the low risk of investing with the Government but not formally rated)

Only banks which meet the following minimum rating criteria for at least two of the designated agencies to be used.

Ratings Agency	Long Term	Short Term
Fitch	AA-	F1+
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(B) UK Investment With Government Equity Holding of minimum of 30%

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Up to a maximum of £60m deposited up to a period of up to three months with the following: -

The current policy stance is overnight but the policy allows changes to reflect market conditions if and when they improve.

Bank
Lloyds/HBOS Nat West/RBS

Only banks which meet the following minimum rating criteria for at least two of the designated agencies are to be used. The banks will not be used if the UK Sovereign rating falls below AAA.

Ratings Agency	Long Term	Short Term
Fitch	A	F1
Moody	A2	P-1
Standards and Poors	A	A-1

The policy retains the ability to revert to some, or even extensive use of the Government's Debt Management Account Deposit Facility (DMADF) if market risk conditions tighten. Other very safe alternative investments will be explored when they become available.

3.7 It was continued to be recognised that movements within the money markets can happen with no notice and the Director of Corporate Resources would have to amend this strategy in order to safeguard Council funds. As in the past any such actions would be reported to the next Cabinet meeting.

3.8 The strategy going forward must continue with the policy of ensuring minimum risk but will also need to deliver secure investment income of at least bank rate on the Council's cash balances. (The actual target is bank rate plus 0.4%). The reduction from bank rate plus 0.5% for 2011/12 reflects the lower rates available in the market on the change to more prudent investments.

3.9 Additional requirements under the Code of Practice require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information has been and will continue to be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Sovereign ratings, Credit Default Swaps, equity prices, the Sector security and liquidity model and the CIPFA National treasury risk model as well as media updates etc.) will be assessed when comparing the relative security of differing investment counterparties.

3.10 All Money Market Funds used will be monitored and chosen by the size of fund, rating agency recommendation, exposure to other Countries (Sovereign debt), weighted average maturity and weighted average life of fund investment and counterparty quality.

3.11 All of the investments will be classified as Specified Investments. These investments are sterling investments of not more than one-year maturity with institutions we deem to be high credit quality or with the UK Government (Debt Management Account Deposit Facility). These are considered low risk assets where the possibility of loss of principal or investment income is small. The County Council does not have any Non Specified Investments which are ones of more than one-year maturity or with institutions which have a lesser credit quality.

4 Authorised Limit for borrowing 2012/13

4.1 The Government introduced a new system for capital finance from 1st April 2004. An objective of this new system was to move away from controlling borrowing through the issue of borrowing approvals, towards a system of self-regulation. This is based on a code of practice developed by CIPFA- the Prudential Code.

The Authorised Limit for borrowing determined for 2012/13 will be the statutory limit determined under section 3(1) of the Local Government Act 2003.

4.2 The Prudential Code for Capital Finance allows capital borrowing to be planned over the same timescale as capital spending. The code states:

"In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that net external borrowing does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years".

The limits set out later in this report have been based upon the amount of capital spending to be financed through borrowing in 2012/13 and following financial year. Whilst the Prudential Code would allow a higher limit than this (2012/13 and next two financial years) it is considered prudent at this stage to base the limits upon 2 years. This approach was agreed by the County Council in July 2004 and has worked well.

4.3 For 2012/13 it is estimated that the Authorised Limit for borrowing is £394m (see table 5.2) should be determined as usual although, as stated earlier, additional external borrowing is not expected to be undertaken.

5 Prudential indicators and Treasury Management indicators

5.1 There are self-imposed prudential and treasury management indicators that are set on an annual basis. The indicators which relate to treasury management are included below:

- Operational Boundary and Authorised Borrowing Limit (which also include short term borrowing) (see paragraphs 5.2 and 5.3 below)
- Interest rate exposures (see paragraph 5.4 below)
- Maturity structure of debt (see paragraph 5.5 below)
- Compliance with the treasury management code of practice (see paragraph 5.6 below)
- Maturity structure of investments (see paragraph 5.7 below)

Operational Boundary and Authorised Limit for Borrowing

5.2

		Original Estimate 2011/12	Revised Estimate 2011/12	Estimate 2012/13	Estimate 2013/14	Estimate 2014/15
		£m	**£m**	**£m**	**£m**	**£m**
	Opening Balance	309	301	313	319	326
P	*** Add PFI schemes**	39	39	39	39	39
	Opening Balance including PFI schemes	348	340	352	358	365
	New borrowing for capital programme	25	25	19	19	21
	Less repayment of debt	-12	-13	-13	-13	-13
A	* **Closing balance (no borrowing in advance)**	361	352	358	365	373
B	**Advance borrowing allowed (£10m plus net borrowing for following year)**	16		16	18	18
A+B	**Operational Boundary**	378		374	383	391
C	**Short Term (£20m)**	20		20	20	20
A+B+C	**Authorised Limit**	398		394	403	411
D	*** Likely Borrowing at 31 March 2012**		264			
D-A-P	*** Remainder of planned borrowing**		**49**			

- **The Closing balance (Capital Financing Requirement) at A less the PFI schemes (P) would equal the Council's external capital debt. Actual external debt (D) is lower as no external borrowing has taken place since 2007/08 (see also paragraph 6.1).**

The proposed Operational Boundary for borrowing is based on the same estimates as the Authorised Limit but without the additional amount for short term borrowing included to allow, for example, for unusual cash movements. The Operational Boundary represents a key management tool for in year monitoring and long term borrowing control.

5.3 The Authorised Limit is consistent with the Council's current commitments, existing plans and the proposals for capital expenditure and financing, and with its approved treasury management policy statement and practices. They are based on the estimate of the prudent but not worst case scenario plus sufficient headroom (short term borrowing) over and above this to allow for day to day operational management, for example unusual cash movements or late receipt of income.

Interest rate exposure

5.4 The Council will continue the current practice of seeking to secure competitive fixed interest rate exposure. It is proposed to continue to set limits which would allow variable rate borrowing and lending in case that becomes a more effective approach. The table below shows both borrowing and lending and a combined borrowing and lending table.

Borrowing	2011/12 Projected Outturn	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Fixed Rate Exposure				
Upper Limit	100%	100%	100%	100%
Lower Limit *	70%	54%	53%	52%
Variable Rate Exposure				
Upper Limit	30%	46%	47%	48%
Lower Limit *	0%	0%	0%	0%

(* assumes all new borrowing is variable)

Lending

Fixed Rate Exposure				
Upper Limit	100%	100%	100%	100%
Lower Limit	0%	0%	0%	0%
Variable Rate Exposure				
Upper Limit	100%	100%	100%	100%
Lower Limit	0%	0%	0%	0%

Borrowing and Lending combined

Fixed Rate Exposure				
Upper Limit	100%	100%	100%	100%
Lower Limit	29%	28%	27%	26%
Variable Rate Exposure				
Upper Limit	100%	100%	100%	100%
Lower Limit	0%	0%	0%	0%

Maturity structure of debt

5.5 The Council has set upper and lower limits for the maturity structure of its borrowings as follows.

	Lower limit	Upper limit	Current
Under 12 months	0%	25%	5%
12 months and within 24 months	0%	40%	1%
24 months and within 5 years	0%	60%	4%
5 years and within 10 years	0%	80%	16%
10years and within 20 years	0%	80%	15%
20 years and within 30 years	0%	80%	16%
30 years and within 40 years	0%	80%	20%
More than 40 years	0%	80%	23%

Compliance with the treasury management code of practice

5.6 East Sussex County Council has adopted in full the *CIPFA Code of Practice for Treasury Management in the Public Services.*

Maturity structure of investments – Investment of surpluses for a period of more than one year and up to five years.

5.7 Investments will be made in line with the strategy and does not allow investments beyond one year.

6 Capital Financing Requirement and Minimum Revenue Provision (MRP) Statement

The Council's Borrowing Need (the Capital Financing Requirement)

6.1 The prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

6.2 Following accounting changes the CFR includes other long term liabilities (e.g. PFI schemes, finance leases) brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £39m of such schemes within the CFR.

6.3 The Council is asked to approve the CFR projections below:

	2011/12 Revised	**2012/13 Estimated**	**2013/14 Estimated**	**2014/15 Estimated**
	£m	***£m***	***£m***	***£m***
Total CFR	**352**	**358**	**365**	**373**
Movement in CFR	**12**	**6**	**6**	**8**

Movement in CFR represented by				
Net financing need for the year (above)	25	19	19	21
MRP/Voluntary Revenue Provision (VRP) and other financing movements	-13	-13	-13	-13
Movement in CFR	**12**	**6**	**6**	**8**

6.4 The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

Minimum Revenue Provision (MRP) Statement

6.5 The statutory requirement for local authorities to charge the Revenue Account each year with a specific sum for debt repayment has been replaced with a more flexible statutory guidance, which came into effect from 2008/09. A variety of options is provided to councils to replace the existing Regulations, so long as there is a prudent provision.

6.6 The new statutory duty is that a local authority shall determine for the financial year an amount of minimum revenue provision (MRP) that it considers to be prudent. This replaces the previous prescriptive requirement that the minimum sum should be 4% of the Council's Capital Financing Requirement (CFR).

6.7 To support the statutory duty the Government also issued a guidance, which requires that a Statement on the Council's policy for its annual MRP should be submitted to the full Council for approval before the start the financial year to which the provision will relate. The Council are therefore legally obliged to have regard to this MRP guidance in the same way as applies to other statutory guidance such as the CIPFA Prudential Code, the CIPFA Treasury Management Code and the CLG guidance on Investments.

6.8 The MRP guidance offers four options under which MRP might be made, with an overriding recommendation that the County Council should make prudent provision to redeem its debt liability over a period which is commensurate with that over which the capital expenditure is estimated to provide benefits (i.e. estimated useful life of the asset being financed).

6.9 The guidance also requires an annual review of MRP policy being undertaken and it is appropriate that this is done as part of this Annual Treasury Management Strategy.

6.10 The move to International Financial Reporting Standards (IFRS) involves Private Finance Initiative (PFI) contracts and some leases (being reclassified as finance leases instead of operating leases) coming onto the County Council Balance Sheets as long term liabilities. This new accounting treatment impacts on the Capital Financing Requirement with the result that an annual MRP provision is required.

6.11 To ensure that this change has no overall financial impact on Local Authorities, the Government has updated their "Statutory MRP Guidance" which allows MRP to be equivalent to the existing lease rental payments and "capital repayment element" of annual payments to PFI Operators. The implications of these changes are now being reflected in the Council's MRP policy for 2012/13.

6.12 The policy recommended for adoption from 1 April 2012 retains the key elements of the policy previously approved but now incorporates the IFRS changes (re PFI and finance leases) and the consequential updated Government Guidance. The policy for 2012/13 is therefore as follows:-

6.13 For capital expenditure incurred before 1 April 2008 or which in the future will Supported Capital Expenditure, the MRP policy will be:

- Based on based on the non-housing CFR, i.e., The Council currently set aside a Minimum Repayment Provision based on basic MRP of 4% each year to pay for past capital expenditure and to reduce its CFR.

6.14 From 1 April 2008 for all unsupported borrowing the MRP policy will be:

- Asset Life Method – MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (this option will be applied for any expenditure capitalised under a Capitalisation Direction).

- Asset Life Method (annuity method) The Council will also be adopting the annuity method, - MRP calculated according to the flow of benefits from the asset, and where the principal repayments increase over the life of the asset. The policy is being adopted as a result of any PFI's assets coming on the balance sheet and any related MRP will be equivalent to the "capital repayment element" of the annual service charge payable to the PFI Operator and for finance leases, MRP will also be equivalent to the "capital repayment (principal) element" of the annual rental payable under the lease agreement.

Under both methods, the Council has the option to charge more than the statutory MRP each year through a Voluntary Revenue Provision (VRP).

6.15 In view of the variety of different types of capital expenditure incurred by the County Council, which is not in all cases capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure.

6.16 This approach also allows the Council to defer the introduction of an MRP charge for new capital projects/land purchases until the year after the new asset becomes operational rather than in the year borrowing is required to finance the capital spending. This approach is beneficial for projects that take more than one year to complete and is therefore included as part of the MRP policy. Half-yearly review of the Council's MRP Policy will be undertaken and reported to Members as part of the Half-yearly Treasury Management Strategy review.

7. Treasury Management Advisers

7.1 The Strategy for 2011/12 explained that the County Council uses Sector as its treasury management consultant on a range of services which include:

- Technical support on treasury matters, capital finance issues and advice on reporting;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments;
- Credit ratings from the three main credit rating agencies and other market information;
- Assistance with training on treasury matters

Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice the final decision on treasury matters remained with the Council. This service remains subject to regular review.

7.2 Sector is the largest provider of Treasury Management advice services to local authorities in the UK and they claim to be the market-leading treasury management service provider to their clients.

7.3 The advice will continue to be monitored regularly in 2012/13 to ensure an excellent level of advisory service provided to our authority.

8 Treasury Management Policy Statement for 2012/13

It is recommended that the Treasury Management Policy Statement for 2012/13 should be unchanged. The Statement is set out below

East Sussex County Council defines its treasury management activities as:

"The management of the organisation's cash flows, its banking, money market and capital market transactions, the effective management of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

The County Council regards the successful identification, monitoring and management of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

This authority acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.