Leeds CITY COUNCIL

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Report of the DIRECTOR OF CORPORATE SERVICES

Executive Board

Date: 9th February 2007

Subject: TREASURY MANAGEMENT STRATEGY 2007/08

Electoral Wards Affected:	Specific Implications For:
	Equality and Diversity ☐
	Community Cohesion ☐
	Narrowing the Gap ☐

Eligible for Call In: no

Not Eligible for Call In (Details contained in the report) ☐

EXECUTIVE SUMMARY

1. This report sets out for Members' approval the Treasury Management Strategy for 2007/08, and also provides an update on the implementation of the 2006/07 strategy.

2. The Council's level of net external debt is anticipated to be £1,261m by March 2007, slightly lower than was anticipated in November 2006 but in line with the approved strategy for 2006/07. Revenue savings of £9.1m from treasury management activity during the year have been achieved.

3. Long term interest rates have remained at historically low rates, and experts continue to predict that they will rise steadily over the next two to five years. In view of this loans of £100m have been borrowed in advance of the 2007/08 borrowing requirement, in order to lock in long term borrowing at the low rates currently available.

4. It is proposed to increase the Authorised Limit for external debt £1,640m from 2007/08.

5. Members are asked to reaffirm the Treasury Management Policy Statement and in particular the amendments made to Section 7 "Approved Instruments and Organisations for Investments". This section details a number of investment instruments available on the market that the Authority may use dependent on current and future revenue balances and the interest rate outlook.

1 Purpose Of This Report

1.1 This report sets out for approval by Members the Treasury Management Strategy for 2007/08 and the revised affordable borrowing limits under the prudential framework. It also provides Members with a review of strategy and operations in 2006/07.

2 Background Information

2.1 The operation of the Treasury Management function is governed by provisions set out under part 1 of the Local Government Act 2003 whereby the Council is required to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities.

2.2 The Prudential Code requires that full Council set certain limits on the level and type of borrowing before the start of the financial year together with a number of Prudential indicators. Council must similarly set any in year revision of these limits. In order to comply with this legal requirement recommendations 7.2, 7.3, 7.4 and 7.5 of this report are not eligible for call-in.

2.3 The Code of Practice requires that policy statements are prepared for approval by the Council at least twice a year. The Policy and Strategy Statement for 2006/07 was approved by the Executive Board on 17th February 2006 and by full Council on 28th February 2006. The 2005/06 Treasury Management Annual Report was considered by Executive Board on 5th July 2006, and a review of the 2006/07 strategy was considered by Executive Board on 15th November 2006.

3 Main Issues

3.1 Review of Strategy and Borrowing Limits 2006/07

3.1.1 The current debt forecasts are given in Table 1 below, which shows that net external borrowing is now expected to be £1,261m by the end of 2006/07, below expectations in November 2006, but still above the forecast at February 2006.

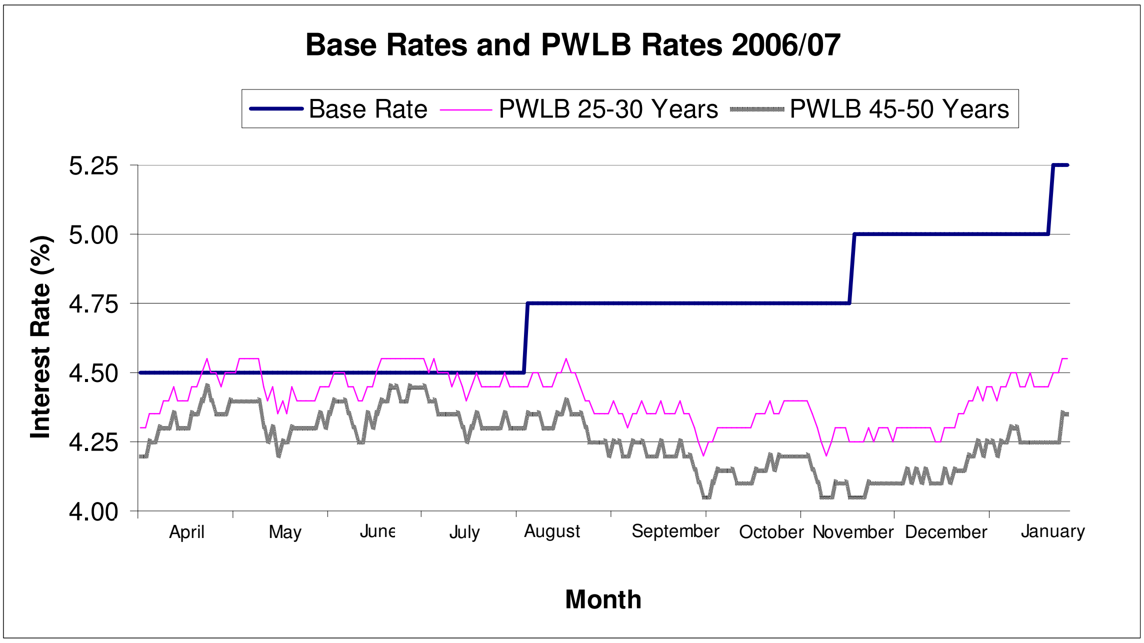
Table 1

ANALYSIS OF BORROWING 2006/07		**2006/07 Feb 06 £m**	**2006/07 Nov 06 £m**	**2006/07 This Report £m**
Net Borrowing at 1 April		1,098	1,054	**1,054**
New Borrowing for the Capital Programme – Non HRA		67	121	**113**
New Borrowing for the Capital Programme – HRA		99	119	**118**
Debt redemption costs charged to Revenue (Incl HRA)		(22)	(21)	**(21)**
Reduced/(Increased) level of Revenue Balances		(3)	(3)	**(3)**
Net Borrowing at 31 March		1,239	1,270	**1,261**
* Comprised as follows				
Long term borrowing	Fixed	997	1,313	**1,201**
	Variable	45	40	**40**
	New Borrowing	165		**101**
Short term Borrowing		32	17	**19**
Total External Borrowing		1,239	1,370	**1,361**
Less Investments		-	100	**100**
Net External Borrowing		1,239	1,270	**1,261**
% borrowing funded by short term and variable rate loans		20%	4%	**12%**

Note: The Capital Financing Requirement (CFR) is the maximum level of debt (i.e. borrowing and finance leasing) that the Council can hold for its current year capital purposes. The Council is also allowed to borrow in advance for up to two future years capital programmes.

3.1.2 Interest rate movements during the year are shown on the graph below. The base rate moved upwards in August 2006 to 4.75%. This increase was earlier than anticipated by most forecasters and was against a background of firm growth in the economy, rapid growth in the supply of money and credit and indications that inflation was likely to remain significantly above the target of 2.0%. Forecasters correctly predicted a further rise of 0.25% in November 2006. The market was again surprised by a further increase in base rates of 0.25% to 5.25% in January 2007. The Bank of England cited concerns over stronger than expected growth linked to domestic demand and the expansion of credit and the availability of money in the economy. They also stated that the risks to inflation were on the upside and the December inflation figures showed that CPI hit 3.0%, the highest since comparable records began over ten years ago. Economists now predict another 0.25% Base Rate rise in February or March to 5.5%.

3.1.3 The Council's treasury advisors latest forecast are for base rates to rise to 5.5% but then fall by 0.25% in the last quarter of 2007 and by a further 0.25% in both Quarter 1 and Quarter 2 of 2008 resulting in Base Rates of 4.75%. Long term rates have risen since the July half year report and have ranged between 4.05% and 4.45% for the 45-50 year period. The rise has been attributed to the increased inflationary pressure. The Council's treasury advisors' latest forecasts are for long term rates to average 4.25% for both 2007 and 2008. There remains the possibility of long terms rates falling at the end of the financial year when traditionally demand for Government gilts increases.



3.1.4 Monitoring of the long term rates has presented opportunities to restructure £401.3m of loans as shown in Table 2 to generate current and future year revenue savings. This included £306.3m of PWLB loans and a further £95m of market loans. The restructuring of market loans also had the objective of removing the number of opportunities for the lender to vary the interest rate on the loans and thereby reduces volatility.

Table 2

Rescheduling 2006/07									
Premature Repayments						New Borrowing			
Date	Amount (£m)	Original Rate	Discount Rate	Discount (£m)		Date	Amount (£m)	Term (Years)	Interest Rate (%)
PWLB						PWLB			
02/05/06	14	4.625	4.80	0.257		28/04/06	22	45	4.4
02/05/06	23	4.5	4.65	0.448		28/04/06	22	46	4.4
02/05/06	12	4.5	4.65	0.245		28/04/06	26	47	4.4
02/05/06	5	4.55	4.65	0.072		28/04/06	22	48	4.4
02/05/06	30	4.5	4.65	0.655		28/04/06	22	50	4.4
02/05/06	30	4.5	4.65	0.660		19/05/06	20	36	4.3
18/05/06	20	4.6	4.75	0.378		19/07/06	30	47	4.25
06/07/06	30	4.35	4.55	0.960					
21/09/06	30	4.35	4.9	0.899					
22/12/06	12.3	4.15	4.35	0.464					
03/01/07	25	4.25	4.5	0.948					
08/01/07	20	4.625	4.65	0.066					
08/01/07	25	4.55	4.65	0.354					
08/01/07	30	4.45	4.5	0.239					
Sub Total	**306.3**						**164**		
LOBOs						LOBOs			
24/04/06	5	4.25				24/04/06	5	60	4.15
24/04/06	10	4.81				24/04/06	10	60	4.81
28/04/06	5	3.995				24/04/06	5	60	3.995
02/05/06	20	3.98				02/05/06	10	60	3.96
08/05/06	5	4.75				02/05/06	10	60	3.96
19/09/06	15	4.4				08/05/06	5	60	4.33
21/09/06	20	4.5				01/06/06	10	60	3.68
21/09/06	15	4.34				01/06/06	10	60	3.78
						01/06/06	10	60	3.83
						19/09/06	15	70	4.25
						21/09/06	20	70	4.45
						21/09/06	15	70	4.24
Sub Total	**95**						**125**		
Total	**401.3**			**6.645**			**289**		

3.1.5 Of the £306.3m PWLB loans repaid, £164m has been rescheduled as new PWLB loans, £30 has been rescheduled into LOBOs, £12.3m will not be replaced due to slippage in the 2006/07 capital programme, and as rates have fluctuated in recent months, further opportunities to restructure the debt portfolio have arisen leaving £100m of loans which are in the process of being rescheduled to generate further revenue savings in the current and future years. In total, market conditions have enabled restructuring to generate savings to date of £9.1m. The Director of Corporate Services will continue to monitor market conditions to identify any further opportunities.

3.1.6 To meet the borrowing requirement for the year, new loans of £165m have been taken, £130m from PWLB and £35m in market loans, which were arranged before 01/04/06. These market loans are termed Lenders Option Borrowers Option (LOBO) and contain clauses which allow the lender, at pre-determined dates, to vary the interest rate on the loan. If one of these options is exercised and the new rate is not accepted, the borrower then has the option to repay the loan. Details of new borrowing for 2006/07 undertaken during the year are set out in Table 3.

3.1.7 As reported in November 2006, historically low PWLB interest rates in the 45-50 year band presented the opportunity to borrow in advance a substantial part of the 2007/08 borrowing requirement, investing the amounts until they are required. Details are shown in Table 3.

Table 3

New Borrowing for 2006/07 Requirement				
Date	Source	Amount (£m)	Term (Years)	Interest Rate (%)
03/04/06	Market Loan	10	60	3.52
03/04/06	Market Loan	10	60	3.58
03/04/06	Market Loan	5	60	3.40
03/04/06	Market Loan	10	60	3.38
16/06/06	PWLB	30	50	4.25
19/07/06	PWLB	25	46	4.25
14/09/06	PWLB	30	49	4.20
14/09/06	PWLB	25	48	4.20
29/09/09	PWLB	20	48	4.05
		165		
Pre Funding for 2007/08 Requirement				
Date	Source	Amount (£m)	Term (Years)	Interest Rate (%)
19/05/06	PWLB	20	43	4.25
19/05/06	PWLB	20	44	4.25
19/05/06	PWLB	30	50	4.25
19/05/06	PWLB	30	42	4.25
		100		

3.2 Strategy for 2007/2008

Table 4

ANALYSIS OF BORROWING 2006/07 – 2009/10		**2006/07 £m**	**2007/08 £m**	**2008/09 £m**	**2009/10 £m**
Net Borrowing at 1 April		1,054	1,261	1,397	1,438
New Borrowing for the Capital Programme – Non HRA		113	47	32	31
New Borrowing for the Capital Programme - HRA		118	117	38	12
Debt redemption costs charged to Revenue (Incl HRA)		(21)	(25)	(26)	(26)
Reduced/(Increased) level of Revenue Balances		(3)	(3)	(3)	(3)
Net Borrowing at 31 March		1,261	1,397	1,438	1,452
* Comprised as follows					
Long term borrowing	Existing Fixed	1,201	1287	1,313	1,354
	Existing Variable	40	55	65	65
	New Borrowing	101	36	41	14
Short term Borrowing		19	19	19	19
Total External Borrowing		1,361	1,397	1,438	1,452
Less Investments		(100)	-	-	-
Net External Borrowing		1,261	1,397	1,438	1,452
% gross borrowing exposed to interest rate risk		12%	7%	9%	7%

Note: Borrowing exposed to interest rate risk in any one year is made up of short term borrowing, new long term borrowing and existing variable loans (i.e. LOBOs with an option falling within the year).

3.2.1 The table above shows that net external borrowing is expected to rise by £136m during the course of 2007/08 of which £100m was secured in 2006 and invested until required. As in recent years, borrowing to fund the HRA capital programme is anticipated to be higher than that required to fund the General Fund capital programme due to the level of borrowing supported by Government for housing decency works. In addition, with effect from 2007/08, the Department for Transport has switched funding of major transport schemes from supported borrowing to capital grant, thereby reducing the borrowing requirement.

3.2.2 As already stated in paragraph 3.1.2, Base Rates is expected to rise to 5.50% in the short term falling back to 4.75% by quarter 2 2008. Long term rates are expected to average 4.25% for both 2007 and 2008.

3.2.3 The Director of Corporate Service will continue to monitor market conditions so that debt rescheduling and interest savings can be made. However, the effect of proposed changes to the accounting treatment of premiums and discounts will limit the value of discounts that could be taken directly to revenue in 2007/08.

3.3 Borrowing Limits for 2006/07, 2007/08, 2008/09 and 2009/10

3.3.1 The Council is required to set its limits for external debt for 2006/07, 2007/08, 2008/09 and 2009/10 in accordance with the Local Government Act 2003, having regard for CIPFA's prudential code. These limits and other prudential indicators are detailed in Appendix A.

3.3.2 The authorised limit represents the legislative limit on the Council's external debt under the Local Government Act 2003. It should be set with sufficient headroom above the operational boundary to allow flexibility for planned borrowing to be undertaken, in order for prudent treasury management decisions to be taken and temporary cash flow fluctuations to be managed. It is recommended that Council approve the following authorised limits for its gross external debt for the next three years. Council is also asked to delegate authority to the Director of Corporate Services to make adjustments between the two separate limits provided that the overall limit remains unchanged. Any such adjustments will be reported to the next available Council meeting following the change.

3.3.3 Full Council on 1st November 2006 approved revised operational boundary and authorised limit for its external debt for 2006/07 and it is proposed to maintain the limit for 2006/07.

3.3.4 The Council is active in looking for opportunities to prematurely repay loans and replace them at more advantageous rates to reduce interest costs and generate one off savings. To enable this to be done effectively the authorised limit needs to include sufficient flexibility to allow re-financing of loans to take place before loans are repaid, should rates be advantageous and market conditions allow. The limit from 2007/08 has been raised to take advantage of market conditions. Recommended limits are outlined below:

Recommended: Authorised Limits as follows:

Authorised Limit	**2006/07 £m**	**2007/08 £m**	**2008/09 £m**	**2009/10 £m**
Borrowing	1,550	1600	1,600	1,600
Other Long Term Liabilities	40	40	40	40
Total	**1,590**	**1,640**	**1,640**	**1,640**

3.3.5 The operational boundary should reflect the maximum anticipated level of external debt consistent with budgets and cash flow forecasts. It should be seen as a management tool for ongoing monitoring of external debt, and may be breached temporarily due to unusual cash flow movements. However, a sustained or regular trend above the operational boundary should trigger a review of both it and the authorised limit. The Council is asked to approve the operational boundaries set out below, and to delegate authority to the Director of Corporate Services to make adjustments between the two separate boundaries provided that the overall boundary remains unchanged. Any such adjustments will be reported to the next available Council meeting following the change.

Recommended: Operational Boundaries as follows:

Operational Boundary	**2006/07 £m**	**2007/08 £m**	**2008/09 £m**	**2009/10 £m**
Borrowing	1,460	1,460	1,460	1,460
Other Long Term Liabilities	30	30	30	30
Total	**1,490**	**1,490**	**1,490**	**1,490**

3.4 Treasury Management Indicators

3.4.1 The first prudential indicator in respect of treasury management is that the Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Services. This was adopted by the Council at the Executive Board meeting on the 13th March 2003.

3.4.2 The Council is required to set an upper limit on its fixed interest rate exposures for 2007/08, 2008/09 and 2009/10. This limit represents the maximum proportion of its net borrowing (i.e. measured as a percentage of its total borrowing less investments) which the Council will have at any given time during the period at fixed interest rates. The purpose of the limit is to ensure that the Council has the flexibility to take advantage of falling interest rates by ensuring a minimum level of variable rate debt. However setting a limit less than 100% can restrict the Council's ability to borrow in advance of need when long term fixed interest rates are at their low point. (This is the case since in general amounts borrowed in advance are invested, meaning that the net borrowing figure on which the limit is based will be lower than the total borrowing outstanding.) Therefore to provide the Council with maximum flexibility it is recommended that a limit of 115% be set for each year.

Recommended: Upper limit on fixed interest rate exposures for 2007/08, 2008/09 and 2009/10 of 115%

3.4.3 The Council is required to set an upper limit on its variable interest rate exposures for 2007/08, 2008/09 and 2009/10. This limit represents the maximum proportion of debt the Council will have at any given time during the period at variable interest rates and exposed to interest rate rises. In evaluating this figure, LOBOs are treated as being variable in years in which options occur and fixed in other years. The limit should be set in order to maintain a balance between managing the risk of rates rises and allowing sufficient flexibility to take advantage of any falls in rates. It is therefore recommended that a limit of 40% of debt be set for each year.

Recommended: Upper limit on variable interest rate exposures for 2007/08, 2008/09 and 2009/10 of 40%

3.4.4 The Council is required to set upper and lower limits for the maturity structure of its borrowings. This is designed to limit the risk of exposure to high interest rates by restricting the level of maturing debt in any given year. The limits represent the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate and are proposed as follows:

	Cumulative Upper limit	Lower limit
Under 12 months	30%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	40%	0%
5 years and within 10 years	50%	0%
10 years and above	90%	25%

Recommended: Upper and Lower limits on fixed rate maturity structure as above.

3.5 Investment Strategy and Limits

3.5.1 The Council's external debt is reduced by the availability of revenue balances. The Treasury Policy allows for the external investment of these balances should this prove cost effective. This could be undertaken by the Council or by External Fund managers on the Council's behalf. Throughout 2006/07, the Director of Corporate Services has kept the interest outlook under review and investment of surplus balances in general has been limited to cash flow and liquidity management. The exception to this has been the investment of amounts borrowed to pre-fund £100m of the 2007/08 requirement.

3.5.2 The Director of Corporate services will continue to monitor the interest rate outlook and seek to maximise the return on revenue balances. This will be done by the use of external fund managers or directly with counterparties by investing in a range of investment instruments, for example, fixed rate deposits, callable range accruals etc, with a full assessment of the risks involved

3.5.3 With effect from the 1st April 2004, to coincide with the introduction of the Prudential code, ODPM issued legislation and guidance on Local Government Investments. This legislation allows Councils with external debt to hold investments for more than 364 days, a freedom not previously allowed. Further freedoms were also introduced which give Councils greater flexibility and hence access to higher returns, provided that any investment strategy is consistent with the Prudential framework. The Prudential code requires that Councils set limits on investments for periods longer than 364 days. This limit was increased to £150m to facilitate borrowing in the current year for part of the 2007/08 requirement. It is recommended that this limit be rolled forward into future years.

Recommended: Upper limit on sums invested for periods longer than 364 days:

Total principal sum invested for a period longer than 364 days	2006/07 £m	2007/08 £m	2008/09 £m	2009/10 £m
Upper limit	150	150	150	150

3.5.4 Within these overall limits, the Council's treasury policy restricts the amount which can be invested at any one time with individual borrowers, in order to minimise the exposure to risk. The Council's treasury advisers provide regularly updated lists of credit ratings for potential borrowers, drawn from an international credit rating agency. The agreed treasury policy is to lend up to £15m to institutions with an excellent credit rating (typically UK clearing banks or other large financial institutions), and up to £5m for up to 3 months to institutions with good credit ratings. A number of these institutions exist within the same group of companies as parents or subsidiaries. To further limit the risk exposure of the council it is recommended that a group borrowing limit of £30m be set. These limits do not apply to the Councils' Banker where we have an unlimited deposit facility as part of our banking arrangements.

3.5.5 In accordance with the Prudential code the Council has created and maintained a Treasury Management Policy. Revisions to parts of the policy have been approved by Members from time to time in the annual strategy and half year updates on Treasury Strategy. It is recommended that the entire policy which is updated and attached at appendix C is reaffirmed. Members are asked to note the amendments made to Section 7 "Approved Instruments and Organisations for Investments" which details a number of investment instruments available on the market. These instruments would only be used after a full risk analysis has been undertaken to include examination of current and future revenue balances and the interest rate outlook.

4 Implications For Council Policy And Governance

4.1 The operation of the Treasury Management function is governed by provisions set out under part 1 of the Local Government Act 2003 whereby the Council is required to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities.

4.2 The Prudential Code requires that full Council set certain limits on the level and type of borrowing before the start of the financial year together with a number of Prudential indicators. Any in year revision of these limits must similarly be set by Council.

4.3 The Code of Practice requires that policy statements are prepared for approval by the Council at least twice a year. This treasury management strategy statement for 2007/08 seeks approval in accordance with the code.

5 Legal And Resource Implications

5.1 The treasury management strategy for 2007/08 and update of 2006/07 recognises the increase in borrowing required to fund the capital programme requirements of both General Fund and HRA.

6 Conclusions

6.1 The treasury management strategy 2007/08 enables borrowing to be undertaken to fund the capital programme for both General Fund and HRA

7 Recommendations

That the Executive Board :

7.1 Approve the initial treasury strategy for 2007/08 as set out in Section 3.2 and note the review of the 2006/07 strategy and operations set out in Section 3.1.

7.2 Recommend to Council the setting of borrowing limits for 2007/08, 2008/09 and 2009/10 as set out in Section 3.3.

7.3 Recommend to Council the setting of treasury management indicators for 2007/08, 2008/09 and 2009/10 as set out in Section 3.4.

7.4 Recommend to Council the setting of investment limits for 2007/08, 2008/09 and 2009/10 as set out in Section 3.5.

7.5 Recommend to full council to reaffirm the Treasury Management Policy Statement and note the amendments to Section 7: “Approved Instruments and Organisations for Investments” as attached at Appendix C.

Appendix A

Leeds City Council - Prudential Indicators 2006/07 - 2009/10

No.	PRUDENTIAL INDICATOR	2006/07	2007/08	2008/09	2009/10
	(1). EXTRACT FROM BUDGET AND RENT SETTING REPORTS				
	Ratio of Financing Costs to Net Revenue Stream				
1	General Fund - Excluding DSG (Note1)	8.01%	10.75%	10.63%	10.28%
2	HRA	14.94%	16.26%	16.60%	15.90%
	Impact of Unsupported Borrowing on Council Tax & Housing Rents	**£ . P**	**£ . P**	**£ . P**	**£ . P**
3	increase in council tax B7(band D, per annum) (Note 2)	37.24	54.14	57.84	61.26
4	increase in housing rent per week	0.00	0.00	0.00	0.00
5	Net Borrowing and the capital financing requirement (Note 3)	OK	OK	OK	OK
	Estimate of total capital expenditure				
6	Non HRA	198,108	236,131	154,503	99,397
7	HRA	170,227	160,625	82,698	56,179
	TOTAL	368,335	396,756	237,201	155,576
	Capital Financing Requirement (as at 31 March)	**£'000**	**£'000**	**£'000**	**£'000**
8	Non HRA	694,580	717,046	723,146	728,497
9	HRA	652,373	769,226	807,388	819,033
	TOTAL	1,346,953	1,486,272	1,530,534	1,547,530

No.	PRUDENTIAL INDICATOR	2006/07	2007/08	2008/09	2008/09
	(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'000**	**£'000**	**£'000**	**£'000**
10	**Authorised limit for external debt - (Note 5)**				
	borrowing	1,550,000	1,600,000	1,600,000	1,600,000
	other long term liabilities	40,000	40,000	40,000	40,000
	TOTAL	1,590,000	1,640,000	1,640,000	1,640,000
11	**Operational boundary - (Note 5)**				
	borrowing	1,460,000	1,460,000	1,460,000	1,460,000
	other long term liabilities	30,000	30,000	30,000	30,000
	TOTAL	1,490,000	1,490,000	1,490,000	1,490,000
14	**Upper limit for fixed interest rate exposure**				
	Net principal re fixed rate borrowing / investments OR:-	115%	115%	115%	115%
15	**Upper limit for variable rate exposure**				
	Net principal re variable rate borrowing / investments OR:-	40%	40%	40%	40%
17	**Upper limit for total principal sums invested for over 364 days (Note 5**	150,000	150,000	150,000	150,000
	(per maturity date)				

16	**Maturity structure of fixed rate borrowing 2006/07 -> 2008/9**	**Lower Limit**	**Cumulative Upper Limit**	**Projected** 31/03/07
	under 12 months	0%	30%	0.00%
	12 months and within 24 months	0%	30%	5.64%
	24 months and within 5 years	0%	40%	14.78%
	5 years and within 10 years	0%	50%	4.47%
	10 years and above	25%	90%	75.11%

Notes.

1 **The indicator for the ratio of financing costs to net revenue stream for General Fund is now calculated based on the Net Revenue Charge less the Dedicated Schools Grant (DSG). The Government changed the funding of education to DSG from 2006/07.**

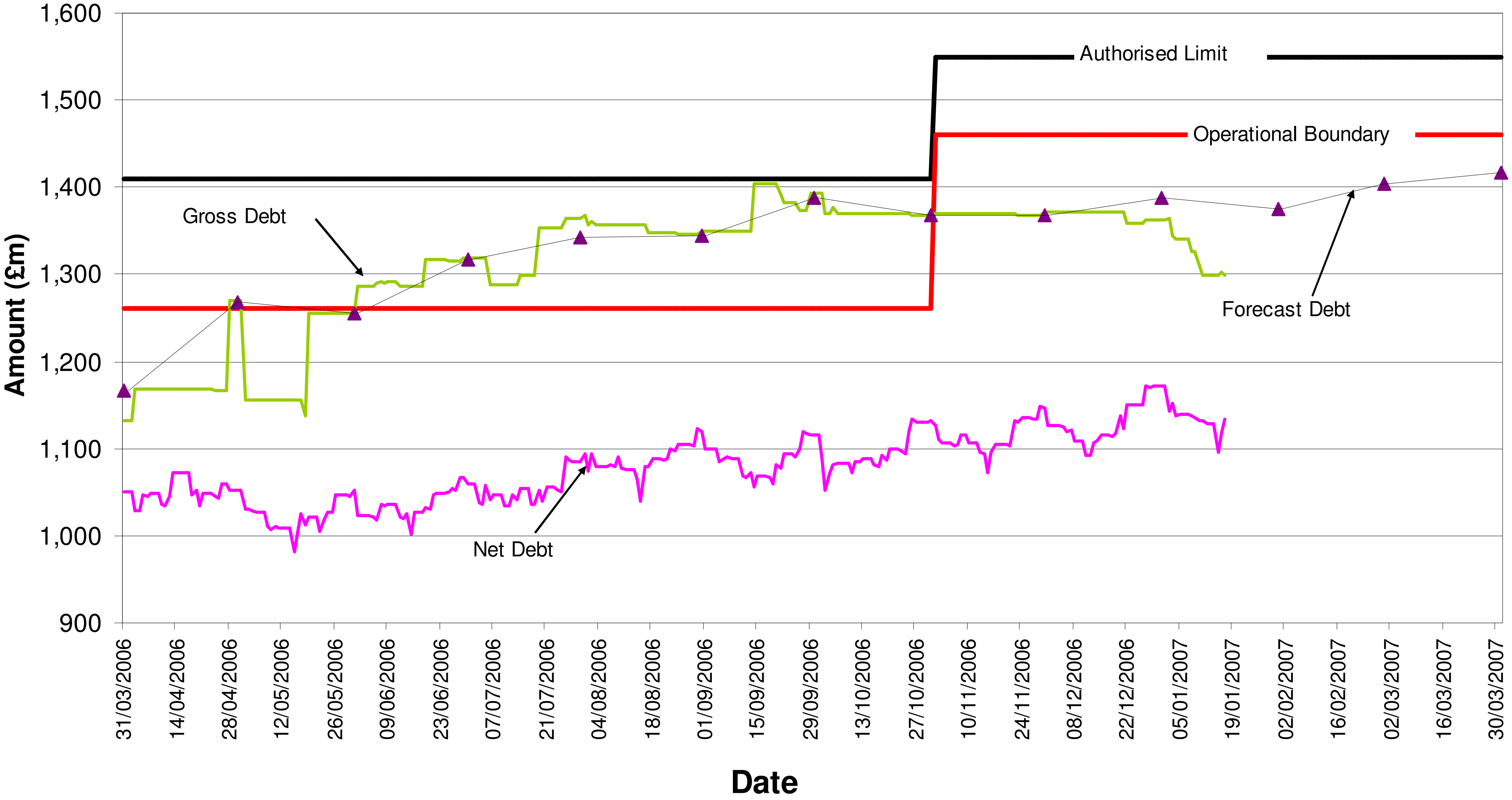
2 **The code requires that the Council identifies the capital financing costs arising from unsupported borrowing expressed as the amount per band D property.**

3 **In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council should ensure that net external borrowing does not exceed the total capital financing requirement in the preceding year plus estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.**

4 **Prudential indicator 12 relates to actual external debt at 31st March, which will be reported in the Treasury Management Annual Report.**

Prudential indicator 13 relates to the adoption of the CIPFA Code of Practice on Treasury Management. The Council formally adopted this Code of Practice in March 2003.

Prudential Code Monitoring 2006/07 - Debt



Appendix B

Appendix C

Treasury Management Policy Statement

1 Introduction

1.1 The following documents sets out the Treasury Management Policy Statement (TMPS) for the Authority, which fully complies with the requirements of the Prudential Code.

2 Background

2.1 CIPFA first published its Code of Practice on Treasury Management in May 1992, there have been subsequent revisions over the years culminating in the latest version of the code, which recommends that all public service organisations adopt, as part of their standing orders and financial procedures, the following four clauses.

a) This Authority adopts the key recommendations of CIPFA's *Treasury Management in the Public Services: Code of Practice* (the Code), as described in Section 4 of that Code.

b) Accordingly, this Authority will create and maintain, as the cornerstones for effective treasury management:

- A TMPS, stating the policies and objectives of its treasury management activities
- Suitable treasury management practices, setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

c) The Executive Board will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, and an annual report after its close, in the form prescribed in its TMPS.

d) This organisation delegates responsibility for the implementation and monitoring of its treasury management policies and practices to the Executive Board, and for the execution and administration of treasury management decisions to the Director of Corporate Services, who will act in accordance with the organisation's TMPS and Treasury Management Practices and, if he/she is a CIPFA member, CIPFA's *Standard of Professional Practice on Treasury Management."*

2.2 CIPFA recommends that an organisation's TMPS adopts the following forms of words to define the policies and objectives of its treasury management activities:

- This organisation defines its treasury management activities as: "The management of the organisation's cash 'flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."
- This organisation regards the successful identification, monitoring and control 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 organisation 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."

2.3 These key recommendations and form of words as specified above were adopted by the Executive Board on the 12th March 2003.

2.4 The operation of the Treasury Management function is governed by provisions set out under part 1 of the Local Government Act 2003 whereby the Council is required to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities.

2.5 The Prudential Code requires that full Council set certain limits on the level and type of borrowing before the start of the financial year together with a number of Prudential indicators. Any in year revision of these limits must similarly be set by Council.

2.6 The requirements of the Prudential Code are set out within the Council's Financial Procedures.

3 Objectives of Treasury Management

3.1 The primary objective is to reduce cost of debt management with which the other objectives are deemed to be consistent. Varying degrees of emphasis will be placed upon the "secondary objectives" at different times contingent upon prevailing market conditions.

3.2 The objectives are identified as follows:

a) To reduce the level of external debt;

b) To ensure that best use is made of the Housing Subsidy Grant and that all new accounting principles are examined to provide benefits where possible;

c) To effect funding at the lowest point of the interest rate cycle;

d) To maintain a flexible approach regarding any financial matters that may effect the Authority;

e) To keep under constant review advice on investment/repayment of debt policy;

f) To maintain a prudent level of volatility dependant upon interest rates;

g) To set upper and lower limits for the maturity structure of its borrowings and to maintain a reasonable debt maturity profile;

h) To specifically ensure that the Leeds City Council does not breach Prudential Limits passed by the Council;

i) To ensure that the TMPS is fully adhered to in every aspect.

4 Approved Activities of the Treasury Management Operation

4.1 The approved activities of the Treasury Management operation cover:

a. borrowing;

b. lending;

c. debt repayment and rescheduling;

d. financial instruments new to the authority;

e. risk exposure; and

f. cash flow.

4.2 It is the Council's responsibility to approve the TMPS. The Executive Board will receive and consider as a minimum:

a) an annual treasury management strategy before the commencement of the new financial year (which sets out the likely operations for the forthcoming year);

b) an annual report on the treasury management activity after the end of the year to which it relates.

4.3 The Director of Corporate Services will:

a) implement and monitor the TMPS, revising and resubmitting it for consideration to the Board and the Council, periodically if changes are required;

b) draft and submit a Treasury Management Strategy to the Board, in advance of each financial year;

c) draft and submit an annual report on treasury management activity to the Board; and

d) implement and monitor the Strategy, reporting to the Board any material divergence or necessary revisions as and when required;

5 Formulation of Treasury Management Strategy

5.1 Whilst this TMPS outlines the procedures and considerations for the treasury function as a whole, requiring revision occasionally, the Treasury Management Strategy sets out the specific expected treasury activities for the forthcoming financial year. This Strategy will be submitted to the Executive Board for approval before the commencement of each financial year.

5.2 The formulation of the annual Treasury Management Strategy involves determining the appropriate borrowing and investment decisions in the light of the anticipated movement in both fixed and shorter term variable interest rates (for instance, the Council may postpone borrowing if fixed interest rates are falling).

5.3 The Treasury Management Strategy is also concerned with the following elements:

a) the prospects for interest rates;

b) the limits placed by Council on treasury activities (per this TMPS);

c) the expected borrowing strategy;

d) the temporary investment strategy;

e) the policy concerning retention of the PCL and investment versus debt redemption;

f) the expectations for debt rescheduling.

5.4 The Treasury Management Strategy will establish the expected move in interest rates against alternatives (using published forecasts where applicable), and highlight sensitivities to different scenarios.

6 Approved Methods and Sources of Raising Capital Finance

6.1 Under the Local Government Act 2003 a local authority may borrow money for:

a) for any purpose relevant to its functions under any enactment, or
b) for the purposes of the prudent management of its financial affairs.

A local authority may not, without the consent of the Treasury, borrow otherwise than in sterling.

6.2 Local authorities have in the past only been able to raise finance in accordance with the Local Government and Housing Act 1989, and within this limit the Council has a number of approved methods and sources of raising capital finance. These are:

		Fixed	Variable
	Public Works Loans Board (PWLB)	•	•
	European Investment Bank (EIB)	•	•
	Stock Issues	•	•
	Market Long-Term	•	•
	Market Temporary	•	•
	Local Temporary	•	•
	Local Bonds	•	
	Overdraft		•
*	Negotiable Bonds	•	•
	Internal (capital receipts & revenue balances)	•	•
*	Commercial Paper	•	
*	Medium Term Notes	•	

* (Not used at present by this Council)

7 Approved Instruments and Organisations for Investments

7.1 With effect from the 1st April 2004, to coincide with the introduction of the prudential code, new legislation has been issued to deal with the issue of Local Government Investments. This legislation lifts the restrictions on Councils with external debt to not hold investments for more than 364 days. Further freedoms are also provided which will give Council's greater flexibility and hence access to higher returns, provided that any investment strategy is consistent with the new prudential framework.

7.2 The Council will have regard to the DCLG Guidance on Local Government Investments issued in March 2004 and CIPFAs Treasury Management in Public Services Code of Practice and Cross Sectrorial Guide. The Council's investment priorities are:

a) The security of capital; and

b) The liquidity of investments

7.3 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The Council does not have the authority to undertake borrowing purely to invest or lend and make a return as this is unlawful and as such will not engage in such activity.

7.4 The Director of Corporate Services will formulate a suitable criteria for assessing and monitoring the credit risk of investment counterparties and shall construct a lending list comprising time, type and specific counterparty limits. This criteria forms part of this Policy and is attached at Annex A.

7.5 Should any revisions occur to the criteria, they will be submitted to the Executive Board for approval. Where individual counterparties newly obtain the required criteria, they will be added to the list. Similarly, those ceasing to meet the criteria will be immediately deleted.

7.6 The Council's approved Treasury Policy is to use the recommended lending list provided by Sector, the Council's treasury advisers. The Sector list is compiled on a matrix approach using data from recognised international credit rating agencies, which provide ratings of institutions across four categories. The Sector list ranks institutions as 'excellent' (or 'red'), 'good' (or 'green'), or no ranking (i.e. not advised to lend to). Sector provide regular updates to this list, as institutions' credit ratings change. The use of the Sector list was introduced and reported to Executive Board in the Treasury Strategy and Policy report of February 2002.

7.7 The Council's policy states that it will lend up to £15 million to an institution ranked as 'excellent' and up to £5 million for up to 3 months to an institution ranked as 'good'. A number of these institutions exist within the same group of companies as parents or subsidiaries. To limit the risk exposure of the council it is recommended that a group borrowing limit of £30m be set. These limits do not apply to the Councils' Banker where we have an unlimited deposit facility as part of our banking arrangements.

Institutions with Short Term rating F1
and Long Term Rating A+, A

Individual	Support			
	1	2	3	4
A	Red	Red	Green	
A/B	Red	Red	Green	
B	Red	Red	Green	
B/C	Green	Green		
C	Green	Green		
C/D				
D				

Where the following investment limits are applied by the Council's Treasury policy :

Sector Ranking	Meaning	Limit on Amount Lent	Limit on Duration
Red	Excellent	£15m	-
Green	Good	£5m	3 Months

7.8 The above criteria typically generates a list of approximately 90 'excellent' rated institutions and 60 'good' institutions

7.9 Within the investment limits outlined above the Council has access to a number of investment instruments. These are listed below as specified and non specified investment categories. Specified investments are defined as “minimal procedural formalities” under the March 2004 ODPM guidance.

a) **<u>Specified Investments</u>**
(All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum ‘high’ rating criteria where applicable)

	Use
Debt Management Agency Deposit Facility	In-house
Term deposits – local authorities	In-house
Term deposits – banks and building societies **	In-house and fund managers

The determination as to whether the following are specified or non specified is at the discretion of the Authority

Fixed term deposits with variable rate and variable maturities: -	
1. Callable deposits	In-house and fund managers
2. Range trade	In-house and fund managers
3. Snowballs	In-house and fund managers
Certificates of deposits issued by banks and building societies	In-house buy and hold and fund managers
UK Government Gilts	In-house buy and hold and Fund Managers
Bonds issued by multilateral development banks	In-house on a ‘buy-and-hold’ basis. Also for use by fund managers
Bonds issued by a financial institution which is guaranteed by the UK government	In-house on a ‘buy-and-hold’ basis. Also for use by fund managers
Sovereign bond issues (i.e. other than the UK govt)	In house on a ‘buy and hold basis’ and Fund Managers
Treasury Bills	Fund Managers
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs):	
1. Money Market Funds	In-house and fund managers
2. Enhanced cash funds	In-house and fund managers
3. Short term funds	In-house and fund managers
4. Bond Funds	In-house and Fund Managers
5. Gilt Funds	In-house and Fund Managers

Note: If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate.

b) **Non-Specified Investments**:

Maturities of ANY period.

	Use
Corporate Bonds : ***the use of these investments would constitute capital expenditure***	In house on a ‘buy and hold basis’ and Fund Managers
Floating Rate Notes : ***the use of these investments would constitute capital expenditure unless they are issued by a multi lateral development bank***	Fund managers

Maturities in excess of 1 year

Term deposits – local authorities	In-house
Term deposits – banks and building societies	In-house
Fixed term deposits with variable rate and variable maturities	
1. Callable deposits	In-house and fund managers
2. Range trade	In-house and fund managers
3. Snowballs	In-house and fund managers
Certificates of deposits issued by banks and building societies	In house on a ‘buy and hold basis’ and Fund managers
UK Government Gilts	In house on a ‘buy and hold basis’ and Fund Managers
Bonds issued by multilateral development banks	In-house on a ‘buy-and-hold’ basis. Also for use by fund managers
Bonds issued by a financial institution which is guaranteed by the UK government	In-house on a ‘buy-and-hold’ basis. Also for use by fund managers
Sovereign bond issues (i.e. other than the UK govt)	In house on a ‘buy and hold basis’ and Fund Managers
Property fund: ***the use of these investments would constitute capital expenditure***	Fund manager
1. Bond Funds	In-house and Fund Managers
2. Gilt Funds	In-house and Fund Managers
Collective Investment Schemes structured as Open Ended Investment Schemes	
Bond Funds	In-house and Fund Managers
Gilt Funds	In-house and Fund Managers

7.10 The Director of Corporate Services will continue to monitor the range of investment instruments available and make changes to the list as appropriate.

8 Policy on Interest Rate Exposure

8.1 As required by the Prudential Code, the Council must approve before the beginning of each financial year the following treasury limits:

a) the overall borrowing limit;

b) the amount of the overall borrowing limit which may be outstanding by way of short term borrowing;

c) the maximum proportion of interest on borrowing which is subject to variable rate interest.

8.2 The Director of Corporate Services is responsible for incorporating these limits into the Annual Treasury Management Strategy, and for ensuring compliance with the limits. Should it prove necessary to amend these limits, the Director of Corporate Services shall submit the changes for approval to the Executive Board before submission to the full Council for approval.

9 Policy on External Managers

9.1 The Authority has recently included in its Policy the appointment of external investment fund managers. In the past, the Council has taken the view that the appointment of external fund managers would not justify the investment of senior management time in terms of the expected marginal return over what could be achieved by investing the funds internally, internal investment reducing the level of the Council's external debt.

9.2 However, the fact that a fund manager's expertise allows for a wider investment portfolio than would be operated by Council officers may give opportunities for capital gains to supplement interest earned on investment of revenue balances.

9.3 It is felt appropriate therefore that the Policy allows for the use of external fund managers and although none are being used at present, this situation will be kept under review. Appointment of a fund manager would take place following a tender exercise and submissions on target performance.

10 Policy on Delegation and Review Requirements and Reporting Arrangements

10.1 The Council is responsible for determining the borrowing limits detailed in section 8 above. Other responsibilities and duties are delegated as follows.

10.2 The Executive Board has responsibility for determining and reviewing treasury strategy and performance. (See section 5 above).

10.3 The Director of Corporate Services and through him/her to his/her staff, has delegated powers for all borrowing and lending decisions. This delegation is required in order that the authority can react immediately to market interest rate movements and therefore achieve the best possible terms. The Director of Corporate Services and staff will operate in accordance with the Code of Practice for Treasury Management in Local Authorities.

10.4 Delegation within the Corporate Services Department operates on the following basis:

a) The practical organisation within the Corporate Services Department is that all aspects of borrowing/lending strategy over the year are determined or reported to regular monthly meetings of the Finance Performance Group attended by the Director of Corporate Services and Chief Officer (Financial Development). Quarterly, treasury strategy review meetings take place with the Senior Treasury Manager and Treasury Manager.

b) Implementation of decisions at such meetings and the day to day management of the Treasury Operations is delegated without limit to the Chief Officer (Financial

Development) and through him/her, or in his/her absence, to either the Senior Treasury Manager or the Treasury Manager.

c) Consultations will be made by the Director of Corporate Services on Treasury Management matters with:

⇒ The Chief Executive : so that he/she can ensure proper Treasury systems are in place and are properly resourced.

⇒ External Treasury Advisers : so that they can advise and monitor the process of fixing strategy and policy on Treasury Matters and advise on the economic outlook, prospects for interest rates and credit worthiness

Annexe A

FITCH CREDIT RATING DEFINITIONS

Source : Fitch Ratings

International Short-Term Credit Ratings

A short-term rating has a time horizon of less than 12 months for most obligations, or up to three years for US public finance securities, and thus places greater emphasis on the liquidity necessary to meet financial commitments in a timely manner.

Fl *Highest credit quality*. Indicates the strongest capacity for timely payment of financial commitments; may have an added "+" to denote any exceptionally strong credit feature.

F2 *Good credit quality*. A satisfactory capacity for timely payment of financial commitments, but the margin of safety is not as great as in the case of the higher ratings.

F3 *Fair credit quality*. The capacity for timely payment of financial commitments is adequate; however, near-term adverse changes could result in a reduction to non-investment grade.

B *Speculative*. Minimal capacity for timely payment of financial commitments, plus vulnerability to near-term adverse changes in financial and economic conditions.

C *High default risk*. Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon a sustained, favourable business and economic environment.

D *Default.* Denotes actual or imminent payment default. "+" or "-" may be appended to a rating to denote relative status within major rating categories. Such suffixes are not added to the 'AAA' long-term rating category, to categories below 'CCC', or to short-term ratings other than 'Fl'.

International Long-Term Credit Ratings Investment Grade

AAA *Highest credit quality*. 'AAA' ratings denote the lowest expectation of credit risk. They are assigned only in case of exceptionally strong capacity for timely payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.

AA *Very high credit quality*. 'AA' ratings denote a very low expectation of credit risk. They indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.

A *High credit quality*. 'A' ratings denote a low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings.

BBB *Good credit quality*. 'BBB' ratings indicate that there is currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity. This is the lowest investment-grade category.

Speculative Grade

BB *Speculative*. 'BB' ratings indicate that there is a possibility of credit risk developing, particularly as the result of adverse economic change over time; however, business or financial alternatives may be available to allow financial commitments to be met. Securities rated in this category are not investment grade.

B *Highly speculative*. 'B' ratings indicate that significant credit risk is present, but a limited margin of safety remains. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favourable business and economic environment.

CCC, CC *High default risk*. Default is a real possibility. Capacity for meeting and C financial commitments is solely reliant upon sustained, favourable business or economic developments. A 'CC' rating indicates that default of some kind appears probable. 'C' ratings signal imminent default.

DDD, DD *Default*. The ratings of obligations in this category are based on and D their prospects for achieving partial or full recovery in a reorganisation or liquidation of the obligor. 'DDD' designates the highest potential for recovery of amounts outstanding on any securities involved. 'DD' indicates expected recovery of 50% - 90% of such outstandings, and 'D' the lowest recovery potential, i.e. below 50%.

Individual Ratings
Fitch's Individual Ratings attempt to assess how a bank would be viewed if it were entirely independent and could not rely on external support. These ratings are designed to assess a bank's exposure to, appetite for, and management of risk and thus represents Fitch's view on the likelihood that it would run into significant difficulties such that it would require support.

A A very strong bank. Characteristics may include outstanding profitability and balance sheet integrity, franchise, management, operating environment, or prospects.

B A strong bank. There are no major concerns regarding the bank. Characteristics may include strong profitability and balance sheet integrity, franchise, management, operating environment or prospects.

C An adequate bank which, however, possesses one or more troublesome aspects. There may be some concerns regarding its profitability and balance sheet integrity, franchise, management, operating environment or prospects.

D A bank which has weaknesses of internal and/or external origin. There are concerns regarding its profitability and balance sheet integrity, franchise, management, operating environment or prospects .

E A bank with very serious problems which either requires or is likely to require external support.
Note: In addition, FITCH uses gradations among these five ratings, i.e AIB, BIC, CID, and DIE.

Support Ratings
Support/Legal Ratings do not assess the quality of a bank. Rather, they are Fitch's assessment of whether it would receive support in the event of difficulties. Fitch emphasises that these ratings constitute their opinions alone - although they may discuss the principles underlying them with the supervisory authorities, the ratings given to banks are Fitch's own and are not submitted to the authorities for their comment or endorsement.

1 A bank for which there is an extremely high probability of external support. The potential provider of support is very highly rated in its own right and has a very high propensity to support the bank in question. This probability of support indicates a minimum Long-term rating floor of 'A-'.

2 A bank for which there is a high probability of external support. The potential provider of support is highly rated in its own right and has a high propensity to provide support to the bank in question. This probability of support indicates a minimum Long-term rating floor of 'BBB-'.

3 A bank for which there is a moderate probability of support because of uncertainties about the ability or propensity of the potential provider of support to do so. This probability of support indicates a minimum Long-term rating floor of 'BB-'.

4 A bank for which there is a limited probability of support because of significant uncertainties about the ability or propensity of any possible provider of support to do so. This probability of support indicates a minimum Long-term rating floor of 'B'.

5 A bank for which external support, although possible, cannot be relied upon. This may be due to a lack of propensity to provide support or to very weak financial ability to do so. This probability of support indicates a Long-term rating floor no higher than 'B-' and in many cases no floor at all.

It must be emphasised that in the Support rating Fitch is not analysing how "good" or "bad" a bank is, but merely whether in Fitch’s opinion it would receive support if it ran into difficulties.