

REPORT TO: POLICY & RESOURCES COMMITTEE ON 5TH AUGUST 2008

**SUBJECT: CAPITAL INVESTMENT AND TREASURY MANAGEMENT
PERFORMANCE FOR 2007/08**

BY: CHIEF FINANCIAL OFFICER

1. REASON FOR REPORT

- 1.1 The purpose of this report is to present the Committee with details of the Council's performance indicators for Capital Investment and Treasury Management (Prudential Indicators) for the financial year 2007/08.
- 1.2 This Report is submitted to Committee in terms of Sections A(3) and A(7) of the Council's Administrative Scheme relating to monitoring Treasury Management Policy and Capital Expenditure programme.

2. RECOMMENDATION

2.1 The Committee is asked to:

- (a) note the Council's performance of the Prudential Indicators for 2007/08 and**
(b) approve the Council's revised Approved Counterparty Lending List and revised limits.

3. BACKGROUND

- 3.1 As a result of the relaxation of capital restrictions by the Local Government in Scotland Act 2003, the Chartered Institute of Public Finance and Accountancy (CIPFA) has published guidance that sets out a framework for self-regulation of capital spending. This guidance is known as the Prudential Code and establishes controls on investment in capital projects in terms of affordability, prudence and sustainability.
- 3.2 The new Prudential Code for Capital Finance began on 1 April 2004 and operates by the provision of prudential indicators, which highlight particular aspects of capital investment and treasury management. Details of the comparator indicators approved during the financial plan process are shown for comparison with actual performance for 2007/08.

4. Performance Indicators

4.1 Capital Financing Requirement

- 4.1.1 Capital investment can be financed from several sources: capital receipts, capital grants, lump sums from revenue and borrowing (which is repaid from the revenue account).
- 4.1.2 During 2007/08, Capital Expenditure was slightly higher than forecast in May when Comparator Indicators were approved. The main reason for this being General Services capital expenditure funded from revenue.

Table 1: Capital Expenditure for 2007/08

Capital Expenditure	2007/08 Estimate	2007/08 Actual
	£'000	£'000
Education and Social Services	3,928	3,929
Environmental Services	14,053	14,218
Policy	881	833
Total General Services Spend	18,862	18,980
HRA	3,878	3,877
Total Capital Expenditure	22,740	22,857

- 4.1.3 The Capital Financing Requirement (CFR) shows the Council's underlying need to borrow for a capital purpose, based on historical capital spend and capital spend proposed in the year. In order to ensure that over the medium to long term borrowing net of investments will only be for a capital purpose, net borrowing should not, except in the short-term, exceed the total of CFR in the preceding year plus the estimates of any additional capital financing requirement for the current and the next two financial years. The figures for 2007/08 show that the Council has complied with this requirement.

Table 2: Net Borrowing Position and Capital Financing Requirement

	2006/07 Actual Revised	2007/08 Estimate Revised	2007/08 Actual
	£'000	£'000	£'000
Net Borrowing Position	126,053	120,766	123,977
Capital Financing Requirement	157,183	153,907	153,893

Detailed analysis of Capital Financing Requirement is shown in **Appendix 1**.

4.1.4 The borrowing requirement for capital expenditure for the year was £5.2M and there was no maturing long-term debt during 2007/08. Budgeted loan charge instalments totalled £5.1M. The Council remained well within its Capital Financing Requirement and had a net balance in short term investments of over £21M at 31 March 2008.

4.2 Limits on Borrowing Activity

4.2.1 The Council is required to agree an **Authorised Limit** for borrowing for the year. This figure provides for estimated contingencies which may require to be funded in the year in addition to planned capital expenditure. **Table 3** shows that during 2007/08 the Council did not exceed this limit. The Council set the Performance Indicator for the Authorised Limit for External Debt on 5th March 2008 at £144.4M. The Actual External Debt at 31st March 2008 was £142.4M.

Table 3: Authorised Limit for the Council's External Debt

Authorised Limit for External Debt	2006/07 Actual	2007/08 Estimate	2007/08 Actual	2007/08 Actual per Balance Sheet
	£'000	£'000	£'000	£'000
Borrowing	142,421	144,421	142,421	142,878
Other Long Term Liabilities	-	-	-	-
Total	142,421	144,421	142,421	142,878

The debt shown on the Council's Balance Sheet at 31st March 2008 includes accrued interest of £0.457M as required under Financial Reporting Standard 25.

- 4.2.2 In March 2008, the Council set the **Operational Boundary** indicator to equal the authorised limit for 2007/08. **Table 4** shows that this limit was not exceeded.

Table 4: Operational Boundary for 2007/08

	2007/08 Actual
	£'000
Original Indicator for Operational Boundary	144,421
Maximum Borrowing Position during the year	142,421
Minimum Borrowing Position during the year	142,421

4.3 Affordability Indicators

- 4.3.1 These indicators assess the affordability of the capital investment plans and provide an indication of the impact of the capital investment programme on the Council's overall finances.

Table 5: Financing Costs as a percentage of the Net Revenue Stream

	2006/07 Actual	2007/08 Estimate	2007/08 Actual
General Services	7.18%	7.30%	7.29%
HRA	20.52%	19.03%	19.09%

The outturn for 2007/08 is in line with the estimate for 2007/08 and the incremental impact of capital investment for 2007/08 was £23.64 on Band D Council Tax. The Capital Financing costs for the HRA was lower than anticipated because of the policy of funding capital from revenue and receipts where possible and using the "set aside" element to repay existing debt when houses or land are sold and has resulted in an incremental decrease in impact on Council Rent for 2007/08 of £0.41.

4.4 Summary of Factors affecting the Treasury Strategy during 2007/08

- 4.4.1 The 2007/08 Strategy Report approved in February 2007 noted that the global economic outlook was generally optimistic although the Bank of England did have concerns that inflation could increase above the 2% target. As it turned out, the Governor of the Bank of England had to write to the Chancellor in April 2007 to explain why inflation had risen above 3%.
- 4.4.2 The Strategy Report predicted that the Bank of England Base Rate would peak at 5.50%. However the rate peaked at 5.75% in July 2007 and by March was at 5.25%.

4.4.3 During August, the liquidity problems encountered by some financial institutions (“the credit crunch”) hit the money markets and global economy. The ensuing tightening of credit conditions arising from the reluctance of banks to lend to each other, together with a slow down in the housing market and consumer spending saw the Base Rate being reduced by 0.25% in August to 5.50%. A further cut of 0.25% was made in December 2007.

4.4.4 During November 2007 the PWLB announced an amendment to the way in which the premium for early repayment of loans is calculated. This introduced a separate repayment rate, which is significantly less than the rate at which they would lend new money. This decision has reduced the benefits of debt rescheduling for the time being.

4.5 Treasury Decisions taken during the year.

4.5.1 No new borrowing was undertaken during the year. Nor was there any debt rescheduling exercises undertaken, mainly for the reasons outlined in 4.4.4.

4.5.2 Short term investments can be placed on deposit for periods up to 364 days dependant on the Council’s cash flow requirements and interest rates on offer in the money markets. Investments are restricted to financial institutions listed in the Council’s approved Counterparty List to minimise risk whilst optimising returns.

4.5.3 The effects of the liquidity problems encountered by the capital markets has impacted on the Council’s Counterparty List. The list has been reviewed and the revised with the advice of the Council’s Treasury Advisers and the new list is attached (**APPENDIX 2**).

Table 6: Short Term Investments for 2007/08

	Total Sum Deposited	Average Rate (%)
Council's Bankers	£64.27M	5..53
Approved Financial Institutions	£216.275M	5.83

The above figures are cumulative and the actual amount invested at any one time ranged from £14.175M to £28.6M.

4.5.4 Performance of investments is measured against the benchmark of the average 7 day London Interbank Bid Rate (LIBID). During the period the average rate achieved was 5.76% and the LIBID average rate was 5.58%.

4.5.5 The Prudential Code recommends four indicators to contain the activity of the treasury function within limits, thereby reducing the risk of likelihood of an adverse movement in interest rates or borrowing decisions impacting negatively on the Council's overall financial position. The indicators are as follows:

Table 7: Treasury Management Limits on Activity

	2007/08 Estimated Upper Limit		2007/08 Actual Upper Limit	
Limits on fixed interest rates	100%		76.55%	
Limits on variable interest rates	25%		23.45%	
Maturity Structure	Lower	Upper	Upper	Lower
Under 12 months	0%	15%	0%	0%
12 months to 2 years	0%	50%	0%	0%
2 years to 5 years	0%	50%	0%	0%
5 years to 10 years	0%	75%	5%	0%
10 years and above	0%	100%	0%	100%
Maximum principal sums invested > 364 days*	£0M		£0M	

* The use of investments greater than 364 days is currently prohibited by Scottish Legislation. This indicator has therefore been set at nil.

4.5.6 No borrowing was made during the year and the gross borrowing amounts remained at £142.421M throughout the year.

4.6 Treasury Performance Management

4.6.1 **Table 8** below highlights the treasury position at 31st March 2008 compared with the previous year.

Table 8: The Council's Treasury Position

	31 st March 2007		31 st March 2008	
	Actual £'000	Rate %	Actual £'000	Rate %
Fixed Rate Funding – PWLB	109,021	6.00	109,021	6.00
Fixed Rate Funding – Market	0	-	0	-
Variable Rate Funding – PWLB	0	-	0	-
Variable Rate Funding - Market	33,400	3.74	33,400	3.74
Total Debt	142,421	5.47	142,421	5.47
Other Long Term Liabilities	0		0	
Total	142,421	5.47	142,421	5.47

The average interest rate on external borrowings remained the same at 31st March 2007 and 31st March 2008. The Council's internal average interest rate increased from 6.33% to 6.34% due to the calculation for interest on revenue balances being based on average market rates and the denominator base total for internal debt outstanding decreasing by £2M during the year.

4 SUMMARY OF IMPLICATIONS

(a) Corporate Development Plan/Community Plan/Service Improvement Plan

Management of the Council's borrowing and investment activities is in agreement with the Corporate Plan Working Principle, Sound Management of Resources.

(b) Policy and Legal

The Council's treasury management activities are regulated by a number of professional codes, statutes and guidance documents.

The Council has adopted the Chartered Institute of Public Finance and Accountancy Code of Practice for Treasury Management in the Public Sector.

The primary requirements of the Code are: -

- The formulation of a Treasury Management Policy Statement, which sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices, which set out the manner in which the Council will seek to achieve those policies and objectives.
- Submission of an annual strategy report for the forthcoming financial year (approved by Full Council 14th May 2008).

The Local Government in Scotland Act 2003 provides the powers to borrow and invest as well as providing controls and limits on these activities.

(c) Resources (Financial, Risks, Staffing and Property)

The Council has complied with all the relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury activities. The Council is aware of the risks of passive management of the treasury portfolio and, with the support of the Council's treasury advisers, has proactively managed the debt over the year.

There is little risk of volatility of costs in the current debt portfolio as the interest rates are predominantly at fixed, long-term attractive levels. Shorter-term variable rates and the likely future movements in these variable rates predominantly determine the Council's investment return. These returns can therefore be volatile, and, whilst the risk of loss of principal is minimised through the lending list, forecasting accurate returns can be difficult.

(d) Consultations

This Report has been produced in consultation with Sector Treasury Services, the Council's Treasury advisers.

6. CONCLUSION

- 6.1** The borrowing strategy for 2007/08 was based on close monitoring of the interest rate market, with a view to maintaining a sound long-term debt portfolio, while retaining flexibility to take advantage of any opportunities which were afforded. The position of maintaining cash balances to meet ongoing funding needs was employed with these balances being held on short-term deposit.

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