Appendix I

Prudential Indicators 2008/09 to 2011/12

1. The Capital Expenditure Plans

1.1 The Council's gross capital expenditure plans are summarised below in Table A. Total expenditure is partially funded by resources such as capital receipts, capital grants, etc. Any remaining expenditure which cannot be immediately funded from other resources will form a borrowing need.

1.2 A certain level of capital expenditure will be grant supported by the Government; anything above this level will be unsupported and be paid for from the Council's own resources.

1.3 There are two main limiting factors which may impact on the Council's ability to undertake unsupported capital expenditure:

- Whether the revenue resource is available to support in full the implications of capital expenditure, both borrowing costs and running costs.

- The Government may use a control to limit either the total of all councils' plans nationally, or in the event of an assessment by central government that local plans are unaffordable at a specific council, it may implement a local control. No such control was implemented during 2008/09, however, this is a subject of current debate and the situation may change in the future.

1.4 The level of Government support has been provided as part of the settlement for the period 2008/09 to 2010/11. A number of changes and amendments to the timing of capital funding have taken place since the Council was first advised of the level of support in December 2007. These changes have been reflected in the prudential indicators and further changes cannot be ruled out. In addition some of estimates for other sources of funding, such as capital receipts, may be subject to change over this timescale.

1.5 The Council is asked to approve the summary capital expenditure projections for both General Services and HRA in the table below:

Table A:

£000	2008/09 Revised	2009/10 Estimated	2010/11 Estimated	2011/12 Estimated
Capital Expenditure				
Total expenditure	32,092	39,071	34,783	35,479
Financed by:				
Capital receipts	9,829	11,506	9,144	9,327
Capital grants	6,506	7,435	6,288	6,353
Govt supported borrowing	5,070	5,070	5,070	5,070
Revenue	0	0	0	0
Net financing need the year	10,687	15,060	14,341	14,729

1.6 The increase in the projected net financing need for each future year over the 2008/09 revised level relates mainly to the HRA financing need and is mainly due to two main factors.

- Increase in HRA anticipated capital expenditure arising from the investment required to meet the Scottish Housing Quality Standard for proposed retained stock by 2015 as detailed in the HRA Standard Delivery Plan.

- Reduction in HRA anticipated capital receipts due to the current economic and financial climate.

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

2.1 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is a measure of the Council's underlying borrowing need. The net capital financing need (as indicated in Table A) will impact directly on the CFR. The Council is asked to approve the CFR projections below:

Table B:

£000	2008/09 Revised	2009/10 Estimated	2010/11 Estimated	2011/12 Estimated
Capital Financing Requirement				
CFR – Non Housing	117,717	121,180	123,220	125,446
CFR – Housing	85,757	88,279	89,765	91,387
Total CFR	**203,474**	**209,459**	**212,985**	**216,833**
Movement in CFR	1,778	5,985	3,526	3,848

2.2 The expected impact of the capital expenditure decisions above on the Council's debt and investment position are shown in the treasury strategy (Appendix 2).

3. Limits to Borrowing Activity

3.1 Within the prudential indicators there are a number of key indicators to ensure the Council operates its activities within well defined limits.

3.2 For the first of these, the Council needs to ensure that its total borrowing (net of any investments) does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2009/10 and next two financial years. This allows some flexibility for limited early borrowing for future years. Table C compares the estimated net borrowing and the CFR.

Table C:

£000	2008/09 Revised	2009/10 Estimated	2010/11 Estimated	2011/12 Estimated
Gross Borrowing	213,179	219,254	222,870	226,808
Investments	18,282	10,282	10,282	10,282
Net Borrowing	194,897	208,972	212,588	216,526
CFR	203,174	209,459	212,985	216,833
CRF plus premiums	223,700	228,848	231,537	234,548

3.3 It is recognised within the Code (page 24: par. 85) that if a Council holds 'premiums' on their Balance Sheet, in accordance with proper accounting practice, these premiums could cause external borrowing to exceed the CFR limit. In this case, it shall not be construed as a breach of the Code and an additional indicator may be reported to Members for information, showing the CFR including Balance Sheet premiums. It is noted from the figures shown in Table C however that this Council is not in such a position.

3.4 Upon review of the figures in Table C it can be seen that 2009/10 net borrowing is 92% of the 2009/10 adjusted CFR. However in line with the prudential indicated detailed in 3.2 and 3.3 net borrowing for 2009/10 should actually be compared to the CFR for 2011/12. This indicator shows that 2009/10 net borrowing is 89% of the adjusted CFR for 2011/12.

3.5 **The Executive Director of Corporate Services reports that the Council has complied with the requirement to keep net borrowing below the CFR in 2008/09 to date, and no difficulties are envisaged for the current or future years.** This view takes into account current commitments, existing plans, and the proposals in the 2009/10 capital plan.

3.6 A further two prudential indicators control or anticipate the overall level of borrowing. These are:

3.7 **The authorised limit** – This represents a limit which external debt is not allowed to exceed. This needs to be set or revised by Members. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

3.8 **The operational boundary** –This indicator is based on the probable external debt during the course of the year; it is not a limit. Actual external debt could vary around this boundary for short times during the year. It should act as a monitoring indicator to ensure the authorised limit is not breached.

3.9 The Council is asked to approve the following authorised limit and operational boundary:

Table D (£000):

Authorised limit for external debt	**2008/09 Revised**	**2009/10 Estimated**	**2010/11 Estimated**	**2011/12 Estimated**
Borrowing	255,815	263,105	267,444	272,169
Other long term liabilities	0	0	0	0
Total	255,815	263,105	267,444	272,169
Operational boundary for external debt	**2008/09 Revised**	**2009/10 Estimated**	**2010/11 Estimated**	**2011/12 Estimated**
Borrowing	234,497	241,179	245,157	249,488
Other long term liabilities	0	0	0	0
Total	234,497	241,179	245,157	249,488

4. Affordability Prudential Indicators

4.1 The previous sections cover the overall capital and control of borrowing, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These indicate the impact of the capital investment plans on the overall Council's finances. The Council is asked to approve the following indicators:

4.1.1 **Actual and Estimates of the ratio of financing costs to net revenue stream** – This indicator identifies the trend in the cost of capital (loan charges) against the net revenue stream (funding sources e.g. AEF and council tax). The estimates of financing costs include current commitments and the proposals in this budget report.

Table E:

	2008/09 Revised	2009/10 Estimated	2010/11 Estimated	2011/12 Estimated
Non-HRA	6.19%	6.44%	6.47%	6.50%
HRA	41.40%	40.55%	41.32%	41.74%

4.1.2 Estimates of the incremental impact of capital investment decisions on the Council Tax – This indicator identifies the trend in the cost of proposed changes in the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some elements which are estimated over the three year period.

Table F:

	Proposed Budget 2009/10	Forward Projection 2010/11	Forward Projection 2011/12
Council Tax - Band D	£2.31	£2.31	£2.31

4.1.3 Estimates of the incremental impact of capital investment decisions on Housing Rent levels – Similar to the council tax calculation this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in this budget report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

4.1.4 As discussed in 1.6 the increase in each year is mainly due to the combined effect of an increase in projected capital expenditure and a reduction in anticipated capital receipts.

Table G:

	Proposed Budget 2009/10	Forward Projection 2010/11	Forward Projection 2011/12
Weekly Housing Rent levels	£2.10	£2.14	£2.19

Appendix II

Treasury Management Strategy 2009/10 – 2011/12

1. Background

1.1 The treasury management service is an important part of the overall financial management of the Council's affairs. Whilst the prudential indicators in Appendix 1 consider the affordability and impact of capital expenditure decisions, the treasury service covers the effective funding of these decisions. There are specific treasury prudential indicators included in this strategy which need approval.

1.2 The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management). This Council adopted the Code of Practice on Treasury Management on 27 March 2002, and as a result adopted a Treasury Management Policy Statement within its treasury management practices. This meets the requirements of the first of the treasury prudential indicators.

1.3 The policy requires an annual strategy to be reported to Council outlining the expected treasury activity for the forthcoming year. A further report is produced after the year-end to report on actual activity for the year.

1.4 This strategy covers:

- The current treasury position
- The economic climate and expected movement in interest rates
- The Council's borrowing and debt strategy
- Specific limits on treasury activities
- Treasury performance indicators

2. The Current Treasury Position

2.1 The current position of external borrowing for 2008/09 to 2011/12 is as noted in Table H. This takes account of expected capital expenditure and annual repayments in each year. It also notes the level of anticipated investments due to capital and revenue balances held.

Table H:

£000	2008/09 Revised	2009/10 Estimated	2010/11 Estimated	2011/12 Estimated
External Debt				
Borrowing	213,179	219,254	222,870	226,808
Other long term liabilities	0	0	0	0
Debt at 31 March	213,179	219,254	222,870	226,808
Investments				
Total Investments at 31 March	18,282	10,282	10,282	10,282

3. Economic Indicators

3.1.1 Current Economic Situation - The UK economy has entered a profound recession, worsened by a dangerous combination of negative growth and dislocation in the domestic and world financial markets. The situation in the economy is considered critical by the policy setters who are concerned that the testing financial environment, the sharp decline in house prices and persistently tight credit conditions could trigger a collapse in consumer confidence. At best this could deliver a short, sharp downturn, at worst a prolonged Japanese-style recession

3.1.2 The sharp downturn in world commodity, food and oil prices, the lack of domestic wage pressures and weak retail demand promises a very steep decline in inflation in the year ahead. In the recent pre-budget report, the Treasury suggested RPI inflation could fall to minus 2.25% by September 2009. Inflation considerations will not be a constraint upon Bank of England policy action. Indeed, the threat of deflation strengthens the case for more aggressive policy ease.

3.1.3 The Government's November pre-budget report did feature some fiscal relaxation, however, the size of the package is considered insufficient to kick-start the economy. The onus for economic stimulation will fall upon monetary policy and the Bank of England.

3.2 Short Term Interest Rates - The Bank will continue to ease policy and the need to drive commercial interest rates, currently underpinned by the lack of liquidity of the money market, to much lower levels suggests the approach will be more aggressive than might otherwise have been the case. A bank rate below 1% now seems a distinct possibility and short-term LIBOR rates of below 2% may result. Only when the markets return to some semblance of normality will official rates start to increase.

3.3 Longer Term Interest Rates - Long-term interest rates will be the victim of conflicting forces due to the twin effects of exceptionally heavy gilt-edged issuance in the next three years by the Government (totalling in excess of £100bn per annum), and the sale of gilts by the public. The expected impact of these transactions will pull PWLB rates in opposite directions with the overall result being very little movement at the longer end.

Table I:

Annual Average %	Bank Rate	PWLB Rates*		
		5 year	20 year	50 year
2008/09	3.9	4.2	4.8	4.5
2009/10	1.0	2.4	3.9	3.8
2010/11	1.7	3.2	4.1	4.0
2011/12	2.4	4.0	4.3	4.1

Source: Butlers' Medium Term UK rate forecasts – Annual Average (January 2009)
* Borrowing Rates

4. Borrowing and Debt Strategy 2009/10 – 2011/12

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

4.2 Long-term fixed interest rates are at risk of being higher over the medium term. The Executive Director of Corporate Services, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above. It is likely that shorter term fixed rates may provide better opportunities.

4.3 With the likelihood of a steepening of the yield curve debt restructuring is likely to focus on switching from longer term fixed rates to cheaper shorter term debt, although the Executive

Director of Corporate Services and treasury consultants will monitor prevailing rates for any opportunities during the year.

4.4 The option of postponing borrowing and running down investment balances will also be considered. This would reduce counterparty risk and hedge against the expected fall in investments returns.

Table J:

£000	**2008/09 Revised**	**2009/10 Estimated**	**2010/11 Estimated**	**2011/12 Estimated**
Movement in CFR	1,778	5,985	3,526	3,848
Maturing Debt	79	25,044	34	36
Total borrowing need	1,857	31,029	3,560	3,884

5. Investment Strategy

5.1.1 The main principle governing the Council's investment criteria is security and liquidity before interest return - although the return on the investment will be a consideration. After this main principle the Council will ensure:

- It has sufficient liquidity in its investments. For this purpose it will consider the maximum periods for which funds may prudently be committed.

- It maintains a policy covering both the category of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security.

5.1.2 On 12 May 2008 the Scottish Government issued a draft Scottish Statutory Instrument named "The Local Government Investments (Scotland) Regulations 2008" which was due to come into force on 1 April 2009 which states that the Council should prepare and approve a detailed Investment Strategy before the start of the financial year to which it relates.

5.1.3 The introduction of this statutory instrument will be dependent on legislative time and it is unlikely to be enacted prior to September 2009. Therefore, up until the time the Guidance is enacted, the Council will continue the current policy – maintaining all investments less than one year and avoiding money market funds, Gilts, corporate bonds, etc. and the Council will be advised as and when the Investment Guidance is enacted.

5.1.4 The Executive Director of Corporate Services will maintain a counterparty list in compliance with the council's treasury management practices and will revise the criteria and submit it to Council for approval as necessary.

5.2 Expectations on shorter-term interest rates, on which investment decisions are based, show a likelihood of the current 1.0% bank rate continuing throughout 2009 before increasing again into 2010. The Council's investment decisions are based on comparisons between the rises priced into market rates against the Council's and advisers own forecasts.

5.3 There is a clear operational difficulty arising from the current banking crisis. Ideally investments would be invested longer to secure better returns; however, uncertainty over counterparty creditworthiness suggests shorter dated investments would provide better security. The Executive Director of Corporate Services, under delegated powers, will undertake the most appropriate form of investments depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above.

6. Treasury Management Prudential Indicators and Limits on Activity

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

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

- *Upper limits on fixed interest rate exposure* – Similar to the previous indicator this covers a maximum limit on fixed interest rates.

- *Maturity structures of borrowing* – These limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing.

- *Total principal funds invested for greater than 364 days* - in Scotland, councils cannot currently invest for periods greater than one year.

6.2 On 19 January 2009, following advice from the Council's Treasury Advisers, five Public Works Loan Board loans - totalling £24.962m, with an average interest of 4.00% - were replaced with a one year PWLB loan at 1.17%. Estimated savings of £1.075m, including a discount of £0.373m, are anticipated over the next year. Thereafter, further savings will depend on the interest rate prevailing at the time.

6.3 The rescheduling exercise noted above resulted in a breach in the prudential indicator for maturity structure of fixed interest rate borrowing. The Council is responsible for setting its own indicators taking account of risk and the upper limit of fixed rate debt falling due for refinancing within 2 years as reported to Council in the Treasury Management Strategy for 2008/09 was 10%. The actual indicator is currently 11.6%.

6.4 It has been identified that a number of other local authorities have upper limits of fixed rate debt falling due for refinancing within 2 years that range from 15% to 35%.

6.5 Taking into account future interest rate forecasts, and thus the level of risk involved, as well as current practice in other local authorities, the transaction noted in 6.2 was considered to be appropriate given the exceptional nature of the current financial and economic climate.

6.6 As a result of recent activity and the identification of other local authority practice, it is proposed that the upper limit of fixed rate debt falling due for refinancing within 2 years should be increased from 10% to 15%. The proposed indicators are shown within Table K:

Table K:

	2008/09 Upper		2009/10 Upper		2010/11 Upper	
Limits on fixed interest rates	100%		100%		100%	
Limits on variable interest rates	30%		30%		30%	
Maturity Structure of fixed interest rate borrowing						
	Lower	**Upper**	**Lower**	**Upper**	**Lower**	**Upper**
Under 12 months	0%	15%	0%	15%	0%	15%
12 months to 2 years	0%	15%	0%	15%	0%	15%
2 years to 5 years	0%	30%	0%	30%	0%	30%
5 years to 10 years	0%	50%	0%	50%	0%	50%
10 years and above	0%	100%	0%	100%	0%	100%
Maximum principal invested > 364 days	£nil		£nil		£nil	

7. Performance Indicators

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

- Debt – Borrowing - Average rate of borrowing for the year compared to average available
- Debt – Average rate movement year on year

7.1.2 The results of these indicators will be reported in the Treasury Annual Report for 2008/09.