

# **2004/05 OTHER AREAS CAPITAL PROGRAMME, PRUDENTIAL INDICATORS AND 2004/05 TREASURY MANAGEMENT STRATEGY**

## **PROGRAMME AREA RESPONSIBILITY – CORPORATE STRATEGY AND FINANCE**

**CABINET**

**19TH FEBRUARY, 2004**

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### **Wards Affected**

County-wide.

### **Purpose**

To determine the level of unsupported borrowing for capital expenditure for 2004/05 to be recommended to Council; and

To endorse the Prudential Indicators, including the projected Capital Programme, and Treasury Management Strategy for 2004/05 as attached to this report for Council approval.

### **Key Decision**

These are not key decisions. The decisions will not be taken by Cabinet but by Council at its meeting on 5th March, 2004.

### **Recommendations**

- THAT (a) It be recommended to Council that an amount of £5,000,000 be approved by means of unsupported Prudential Borrowing to meet the preferred list of capital projects.**
- (b) The Prudential Indicators detailed in Appendix 1, which include the projected Capital Programme, be endorsed.**
- (c) The Treasury Management Strategy in Appendix 2 be endorsed.**
- (d) It be recommended to Council that the borrowing limits outlined in Appendix 2 be approved.**

### **Reasons**

Cabinet is responsible for recommending to Council the basis for allocating unsupported borrowing in line with the Council's Capital Strategy. The setting of Prudential Indicators and the reporting of the Council's Treasury Management Strategy for the coming financial year is required by the CIPFA Prudential Code for Capital Finance.

## Considerations

### Other Areas Capital Programme

1. At Cabinet on 29th January, members considered the need to fund the 'Other Areas Capital Programme' from Prudential Borrowing. The cost of such borrowing is not supported through the Revenue Support Grant mechanism and must, therefore, be met from Council Tax.
2. Cabinet provisionally endorsed Prudential Borrowing of up to £5,000,000 for 2004/05 and the financing costs of this are contained within the standstill budget reported as part of agenda item 2. **Appendix 1** summarises the Capital Financing costs of this, together with the ongoing costs, should members consider a similar level of Prudential Borrowing for subsequent years. The costs of subsequent years Prudential Borrowing would need to be built into the medium term financial plan. Further capital expenditure can be funded if the specific ongoing capital financing costs can be met from savings within revenue budgets and that budget can be transferred accordingly.
3. Bids have been sought from all areas of the Council which would require Prudential Borrowing as a source of funding. The established Capital Scheme Selection and Prioritisation (SSP) process has been used to assess these bids in a consistent manner against corporate objectives and other key criteria. The bids have been subject to a rigorous review and the scores attached to the recommended bids represent a weighting based on an appraisal of how each bid meets the strategic objectives of the Council and on the strength of a business case model. However, it must be stressed that the scores are purely indicative of the desirability and reasonableness of the bid. These need to be considered in conjunction with other information, such as the extent of any legal requirement and what external funding leverage might be involved.
4. It is, of course, for Cabinet to determine its priorities in establishing the Capital Programme and it is recognised that bids received thus far may not wholly reflect current priorities.
5. Although the SSP process has attempted to capture all capital requirements, it is inevitable that other requirements may exist. Cabinet Members are, therefore, invited to promote schemes for which no bid was submitted for whatever reason, through the relevant Director. Such schemes would need to be evaluated and subsequently considered for funding accordingly. It is recommended that any such additional schemes are submitted by 19 March 2004. A further report would then be presented to Cabinet to finalise those schemes to be progressed from the £5,000,000 allocation to be recommended to Council.
6. **Appendix 1** sets out a summary table of all SSP bids received net of a small amount of supported borrowing available and a revenue contribution towards the Cemetery bid. The total of these bids is £24,643,000 over the four-year period.
7. The first call on the £5,000,000 now being considered is the funding for the North Herefordshire Swimming Pool, which has already been approved by Cabinet.

## **Prudential Indicators**

8. As Cabinet will recall from previous reports, the Prudential Code applies from 2004/05 onwards. The key objectives of the Code are to ensure that capital investment plans and treasury management decisions are made in a manner that supports prudence, affordability and sustainability.
9. The code requires the Council to set a range of Prudential Indicators (PIs) for 2004/05 and, where appropriate, for at least the subsequent two years, in order to support such local decision-making in a manner that is publicly accountable. The PIs must be set before the beginning of each financial year by Council in line with the budget setting process.
10. Regular in-year monitoring of the PIs will take place and any significant deviations from expectations are to be reported accordingly.
11. The framework of PIs has to cover Capital Expenditure plans and Treasury Management and these are set out on **Appendix 4**. These indicators include:
  - Actual and estimated capital expenditure for the current and future years.
  - Ratio of financing costs to net revenue stream.
  - Capital Financing Requirement.
  - Authorised limit for External Debt.
  - Operational boundary for External Debt.
  - Council Tax implications of the incremental effect of capital decisions.
  - Treasury Management Indicators.

## **Treasury Management Strategy**

12. The Council has adopted and is currently working within CIPFA's Code of Practice on Treasury Management in the Public Services (2001).
13. A Treasury Management Strategy for 2004/05 has been prepared that conforms to the CIPFA Code of Practice 2001. This strategy includes a number of PIs specifically relating to Treasury Management and is set out at **Appendix 5**. The Treasury Management PIs are reproduced from the full list of PIs contained in **Appendix 4**. The Strategy has been prepared in line with the Treasury Management Policy adopted by Council in February 2002, a copy of which is attached for reference at **Appendix 6**.
14. The CIPFA Code of Practice 2001 requires chief financial officers to prepare Treasury Management Practice Statements (TMPs). TMPs outline how the Council's strategic policy objectives for treasury management will be achieved and are supported by schedules that describe the specific procedures to be used by the Council's staff involved in treasury management activities. The County Treasurer has prepared TMPs that conform to the CIPFA Code of Practice 2001.

## **Risk Management**

Proposals put forward for consideration have undertaken a rigorous review process, ensuring consistency with the Council's strategic objectives, together with legal and other relevant considerations.

Risk is managed in accordance with the Treasury Management Policy Statement approved by Cabinet in February 2002. The setting and monitoring of Performance Indicators is designed to be a fundamental process in the management of risk.

## **Consultees**

Treasury Management advisers – Sector Treasury Services Limited.

## **Background Papers**

Reports to Capital Strategy and Asset Management Working Group.

## APPENDIX 1

### EXEMPLIFICATION OF CAPITAL FINANCING COSTS OF £5,000,000 PRUDENTIAL BORROWING PER YEAR

	2004/05	2005/06	2006/07	2007/08	2008/09
	£'000	£'000	£'000	£'000	£'000
Prudential Borrowing	5,000	5,000	5,000	5,000	
Cumulative Prudential Borrowing	5,000	10,000	15,000	20,000	
Capital Financing Costs to meet Cumulative borrowing					<b>Total FRM Increase</b>
Interest Element @ 5%*	250	500	750	1,000	1,000
MRP Element @ 4% in subsequent year	Nil	200	400	600	800
<b>Total capital financing requirement</b>	<b>250</b>	<b>700</b>	<b>1,150</b>	<b>1,600</b>	<b>1,800</b>
Cumulative Council Tax increase To meet prudential borrowing	0.4%	1.1%	1.7%	2.2%	2.4%
Annual Council Tax increase To meet prudential borrowing	0.4%	0.7%	0.6%	0.5%	0.2%
<i>* full year effect</i>					

### TOTAL CAPITAL SCHEME SELECTION AND PRIORITISATION BIDS

	2004/05	2005/06	2006/07	2007/08
	£'000	£'000	£'000	£'000
Approved Scheme – North Herefordshire Swimming Pool	1,800	395	63	
Bids for consideration (as per Appendix 2)	5,417	5,783	2,276	1,435
Provisionally deferred bids	3,371	3,816	414	
Supported Borrowing for Other Areas	(127)			
<b>Total needed to meet all bids (net of Revenue contribution)</b>	<b>10,461</b>	<b>9,994</b>	<b>2,753</b>	<b>1,435</b>
<b>Cumulative bids</b>	<b>10,461</b>	<b>20,455</b>	<b>23,208</b>	<b>24,643</b>



## APPENDIX 2

### SCHEMES CONSIDERED BY THE SSP PROCESS SUITABLE FOR PROGRESSING IN 2004/05

Ref	Scheme	2004/05 £	2005/06 £	2006/07 £	2007/08 £	Score %
P/Y	Hereford City of Living Crafts (SSP bid approved in previous year)	60,000	60,000			N/a
3	Kington Wesleyan Chapel – INFO shop and Library	550,000				93
16	Friar St Mus Res & Learning Centre phase 2 and 3	140,000	433,000	216,000		87
44	Aylestone Park	100,000				82
46	Ross Creative Learning Centre	116,587				80
19	Disabled Access	200,000	200,000	200,000		78
18	Salt Barn Provision	260,000				77
5	Crematorium Hereford <i>NB capital financing costs supported from revenue budget of £60,000 PA</i>	1,000,000 (600,000)	1,455,000			75
45	ICT The Golden Thread	2,525,000	2,035,000	1,435,000	1,435,000	75
	<i>Consisting of the following elements...</i>					
	<i>Network Enhancement</i>	<i>1,230,000</i>	<i>950,000</i>	<i>950,000</i>	<i>950,000</i>	
	<i>Flexible working</i>	<i>400,000</i>	<i>250,000</i>	<i>250,000</i>	<i>250,000</i>	
	<i>Continuity/disaster Recovery</i>	<i>250,000</i>	<i>500,000</i>	<i>100,000</i>	<i>100,000</i>	
	<i>Smartcard Technology</i>	<i>395,000</i>	<i>335,000</i>	<i>135,000</i>	<i>135,000</i>	
	<i>Corporate Document Management</i>	<i>250,000</i>				
11	Ross-on-Wye Flood Alleviation	350,000	1,300,000	275,000		72
1	Extension to Hereford Cemetery	100,000				69
22	Upcott Pool	45,000				69
17	Energy conservation	100,000				67
7	Travellers Site at Bromyard	100,000				64
20	Clearbrook Farmhouse	25,000				63
36	Rotherwas Business Centre	150,000	150,000			63
9	Leominster Closed Landfill Site Monitoring Infrastructure	45,000				61
10	Public toilets improvements	150,000	150,000	150,000		55
		<b>5,416,587</b>	<b>5,783,000</b>	<b>2,276,000</b>	<b>1,435,000</b>	

This schedule sets out the detail of bids that meet corporate objectives which could proceed in 2004/05. A summary of each bid is set out below.

**P/Y** The funding for the Hereford City of Living Crafts was approved during the 2003/04 round of SSP. The main aim of the project is to help physically and economically regenerate Hereford City. The scheme is managed by the Hereford City partnership and the details surrounding the scheme and its external funding arrangements are currently under review.

**Ref 3** Kington Wesleyan Chapel INFO Shop and Library has already received preliminary Cabinet approval on the basis of significant external funding of up to £950,000. Subsequent to the bid being submitted, some doubt has been thrown on about half this external funding. A separate report is being produced for Cabinet highlighting this issue, but if that funding is not received, then the Council would have to fund the shortfall. Of the bid, £150,000 is the minimum required to meet the legal requirement for disabled access but this level of spend would not generate the expected external funding. If this scheme goes ahead, it will release the existing Kington Library and area office, which should generate a capital receipt of £187,000

in 2005/06. This receipt can then be used to support further development of INFO shops. The extra revenue costs that will be incurred by this project would be in the region of £45,000 per year.

**Ref 16** Friar Street Museum and Resources Centre will generate significant external funding of over £1,500,000 over three years. This project requires a commitment for funding for a three-year period in order to obtain the external funding. In order to progress this scheme, £120,000 of lottery funding has already been committed. Should the SSP bid be unsuccessful the scheme could not be completed and the lottery funding would have to be de-committed. This means the £120,000 spent would have to be written off and the funding for it would still have to be found from an alternative source. A legal requirement exists to meet disabled access legislation. The minimum cost to meet the legislation would be £145,000, but this would not attract the external funding. The extra revenue costs that will be incurred by this project would be in the region of £13,000 per year.

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**Ref 44** Aylestone Park relates to land purchased under CPO legislation and the £100,000 required is the minimum needed to develop the land to prevent legal action by the previous owners for non-progress. External funding towards this project has been withdrawn meaning the proposed development has had to be greatly reduced.

**Ref 46** Ross Creative Learning Centre will provide facilities for young people and the community of Ross. Although there is no legal need for this project, it will attract significant external funding. It is also forecast to generate revenue income that could be used to meet the capital financing charges of the project.

**Ref 19** The Disabled Access for public areas programme is required to conform to the Disabled Discrimination Act that comes into force in October 2004. The sum required for 2004/05 is the minimum needed to begin addressing the issue. It is accepted that it will not be possible to fully conform to the legislation before October, so the areas of highest priority will be addressed first.

**Ref 18** The provision of a replacement Salt Barn for storage at Rotherwas is required to prevent prosecution for pollution of watercourses. There is also now a specific legal requirement to grit roads and this project is needed to ensure the legislation can be complied with.

**Ref 5** The bid for the Crematorium totals £2,455,000 and has already been re-profiled to move some of the funding requirement into the second year of the project. This bid will be supported by income generated from a surcharge on cremations. This surcharge is expected to generate in the region of £60,000 per year thus supporting around £600,000 borrowing which is shown in the table on **Appendix 2**. This bid has a legal requirement under the Environmental Protection Act to ensure harmful chemicals are removed from emissions.

**Ref 45** The ICT Golden Thread bid is in an early stage of development. This project has no external funding or legislation issues but does have a strong business case and is needed in order to meet eGovernment targets and other business critical concerns. The bid is a composite including an upgraded corporate network, provision for flexible working, business continuity/disaster recovery, smartcard technology and corporate document management. Investment in the ICT network is likely to be a



priority emerging from the Budget Panel where it has been acknowledged that previous investment in this area has been inadequate. The revenue implication for enhancing the network is a cost of £600,000 for 2004/05, with ongoing costs of £533,333 per year thereafter. These revenue costs will be met from within existing IT budgets.

**Ref 11** The Ross-on-Wye flood scheme bid represents 55% of the total cost, with the remainder being funded by grants from Defra. It should be noted that approving this scheme would require a significant commitment for future years. However, if the project is not proceeded with in 2004/05, there is a risk that future grant funding may not be approved by Defra.

**Ref 1** Extension to Hereford Cemetery is needed to ensure the continued use of the cemetery for the next ten years, otherwise the space will be exhausted within two years.

**Ref 22** Upcott Pool opening will provide a natural wildlife site and facility for informal recreation by the public.

**Ref 17** Energy Conservation relates to meeting national energy reduction targets and falls in line with the GEM Initiative. This will result in savings in energy costs, but servicing costs for the new energy management services will be incurred.

**Ref 7** The traveller site at Bromyard refurbishment and remodelling work is subject to an external funding bid of £300,000. Should the external funding bid be unsuccessful, the Council funding of £100,000 will not be required.

**Ref 20** Clearbrook Farmhouse requires major structural works to ensure that the Grade 1 listed property is structurally sound, wind and watertight.

**Ref 36** The Rotherwas Business Centre development will result in incubation units for lease by small and start up businesses. It will include high specification industrial units, conference room and training suite aimed at encouraging growth of hi-tech small and start up businesses. There will be external leverage of up to £1,700,000 generated by this scheme.

**Ref 9** The Leominster Landfill monitoring infrastructure is needed to meet the requirements of the Waste Management Licence. The sum required is the minimum necessary to meet this, and should result in reduced annual monitoring costs. The planning permission for the site requires its complete restoration which is expected to cost around £760,000. A bid for this will be submitted for the 2005/06 round of SSP.

**Ref 10** Improvements to Public Toilets represents an ongoing programme and £150,000 is the minimum necessary to progress this in 2004/05. The future years sums are indicative figures, representing the minimum need for a continual rolling programme of improvement.



## BIDS PROVISIONALLY DEFERRED

Ref	Scheme	Capital Requirement		
		2004/05 £	2005/06 £	2006/07 £
4	Ledbury INFO, St Katherines Houses	75,000	1,500,000	
2	Hereford City One Stop Shop	750,000		
15	INFO Service Centre (Contact Centre)	130,000	50,000	50,000
37	Minibus for Social Care	35,000		
26	Hereford City Christmas Lighting	50,000	10,000	10,000
27	Street Light Column Replacement	250,000	250,000	250,000
28	Additional Street Lighting	30,000	15,000	10,000
8	Access to Library & Info services	59,625	39,000	
33	Sutton Primary School	600,000	1,370,000	59,000
34	Weobley High School - Sports Hall	592,000	582,000	35,000
41	Ross Library	800,000		
		<b>3,371,625</b>	<b>3,816,000</b>	<b>414,000</b>

This schedule sets out the bids that have been provisionally deferred mainly as it is considered that they would be unlikely to proceed in 2004/05. It is anticipated that these will be revised and resubmitted for funding in future years.

**Ref 4, 2, 15, 8, 41** The Ledbury Info, Hereford City One Stop Shop, Info Service Centre, Access to Library and Info Services and Ross library are not in a position to proceed in 2004/05. A staged programme for these is to be provided, and phased bids are to be considered in future years.

**Ref 37** The minibus for Social Care is to be funded from the Social Care capital receipts reserve once an expected capital receipt is realised.

**Ref 26, 27, 28** The Christmas lighting, column replacement and additional lighting capital bids are of a revenue nature. They have no external funding or specific legal issues to be addressed. These schemes are, therefore, provisionally rejected.

**Ref 33, 34** Sutton Primary school and Weobley High School bids have been deferred for reconsideration in 2005/06.

A separate bid for overall rationalisation of administration accommodation was submitted but is not shown in the tables. It is intended that this will be self-financing over the medium term through property disposals. Further information is required and it is not considered that the scheme could be ready to proceed in 2004/05. It will be necessary to address the cash flow aspects of deferred disposals within the Capital Programme. It is not possible, however, to realistically forecast the impact at this time.



## HEREFORDSHIRE COUNCIL

### PRUDENTIAL INDICATORS 2004/05

#### 1. INTRODUCTION

The PIs set out below are recommended by the Prudential Code. However members may prefer additional or alternative indicators that will help with the decision making process. Unless otherwise stated the indicators set out below are based on the assumption of a provisional £5,000,000 Prudential Borrowing per year, which includes the borrowing required for the North Herefordshire Pool. A number of the PIs set out in this report may therefore need to be amended following decisions made by Council.

#### 2. ACTUAL AND ESTIMATED CAPITAL EXPENDITURE

This table takes into account new borrowing for which the government is providing support, government grants, capital receipts, other funding (including s106 receipts) and Prudential Borrowing. This table will need to be updated depending upon Members decisions on the level and allocation of Prudential Borrowing. The second table shows how this programme would be funded.

	2003/04	2004/05	2005/06	2006/07
<b>Capital Programme Area:-</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Economic Development	4,737	4,092	230	95
Education	8,195	7,014	3,071	2,757
Environment General	-	774	652	-
Highways	10,668	11,072	9,776	12,049
Housing	4,802	5,633	5,415	5,067
Policy & Finance - eModernisation	1,087	127	-	-
Policy & Finance - General	1,021	25	-	-
Policy & Finance – Property	1,773	402	212	-
Social Care	411	132	91	-
Social Development	329	2,467	395	63
Potential Prudential Borrowing to be allocated if approved.	N/a	3,200	4,605	4,937
	<b>33,023</b>	<b>34,938</b>	<b>24,447</b>	<b>24,968</b>
<b>By funding</b>				
Capital Receipts Reserve	4,446	4,870	3,721	2,862
Grants	10,956	9,223	3,034	1,620
Credit approvals / SCE(R)	17,621	15,845	12,692	15,486
Agreed Prudential Borrowing	N/a	1,800	395	63
Prudential Borrowing to be agreed	N/a	3,200	4,605	4,937
	<b>33,023</b>	<b>34,938</b>	<b>24,447</b>	<b>24,968</b>

### 3. RATIO OF FINANCING COSTS TO NET REVENUE STREAM

The net revenue stream is the budget amount to be met from Formula Grant and Council Tax income (the budget requirement). The ratio is the proportion of the budget requirement that relates to the ongoing capital financing costs.

	<b>2003/04</b>	<b>2004/05</b>	<b>2005/06</b>	<b>2006/07</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Net Revenue Stream	169,444	188,343	196,470	204,257
Capital Financing Requirement	5,557	7,220	8,877	10,518
Ratio of financing costs to net revenue stream	3.28%	3.83%	4.52%	5.15%

### 4. CAPITAL FINANCING REQUIREMENT

This indicator represents the Authorities underlying need to borrow for a capital purpose.

	<b>2003/04</b>	<b>2004/05</b>	<b>2005/06</b>	<b>2006/07</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Capital Financing Requirement (as at 31/3)	78,090	94,892	111,063	126,538

### 5. AUTHORISED LIMIT FOR EXTERNAL DEBT

The Authorised Limit for external debt represents the absolute maximum level of debt that may be incurred. This limit would only be reached in exceptional circumstances.

	<b>2003/04</b>	<b>2004/05</b>	<b>2005/06</b>	<b>2006/07</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Borrowing	105,000	119,000	142,000	163,000
Other Long Term Liabilities	1,500	3,000	3,000	3,000
<b>Total</b>	<b>106,500</b>	<b>122,000</b>	<b>145,000</b>	<b>166,000</b>

### 6. OPERATIONAL BOUNDARY FOR EXTERNAL DEBT

The Operational Boundary for external debt is the prudent expectation of the maximum level of external debt.

	<b>2003/04</b>	<b>2004/05</b>	<b>2005/06</b>	<b>2006/07</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Borrowing	63,000	73,500	94,500	115,500
Other Long Term Liabilities	1,500	1,500	1,500	1,500
<b>Total</b>	<b>64,500</b>	<b>75,000</b>	<b>96,000</b>	<b>117,000</b>

## 7. COUNCIL TAX IMPLICATIONS OF THE INCREMENTAL EFFECT OF CAPITAL DECISIONS

This indicator represents the increases in Council Tax resulting from unsupported Prudential Borrowing. These figures will need to be revised following the decisions taken by Council.

	2003/04	2004/05	2005/06	2006/07
	£ p	£ p	£ p	£ p
Increase in council tax (Band D, per annum):				
Previously agreed Prudential Borrowing re the North Herefordshire Pool.	N/A	1.35	2.73	3.01
Position if £5,000,000 Prudential Borrowing is taken for 2004/05.	N/A	3.75	7.06	7.34
Position if £5,000,000 Prudential Borrowing is taken for 2004/05 and subsequent years.	N/A	3.75	10.52	17.28

## 8. TREASURY MANAGEMENT INDICATORS

These are specific indicators which relate to the management of the Treasury Management process. The upper limit for variable rate borrowing is recommended to be increased in order to allow more flexibility to react to changes in market conditions.

	2003/04	2004/05	2005/06	2006/07
<b>Upper Limit for Fixed Interest Rate Exposure</b>				
Net principal re fixed rate borrowing / investments	100%	100%	100%	100%
<b>Upper Limit for Variable Interest Rate Exposure</b>				
Net principal re variable rate borrowing / investments	25%	50%	50%	50%
<b>Maturity Structure of new fixed rate borrowing during 2004/05</b>	<b>Upper Limit</b>	<b>Lower Limit</b>		
Under 12 Months	30%	0%		
12 months and within 24 months	60%	0%		
24 months and within 5 years	90%	0%		
5 years and within 10 years	100%	0%		
10 years and above	100%	20%		
<b>Upper Limit for total principal sums invested for over 364 days</b>	<b>2003/04</b>	<b>2004/05</b>	<b>2005/06</b>	<b>2006/07</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
(per maturity date)	7,000	10,000	10,000	10,000





## HEREFORDSHIRE COUNCIL

### TREASURY MANAGEMENT STRATEGY 2004/05

#### 1. INTRODUCTION

- 1.1 The Financial Policy Team is responsible, under the direction of the County Treasurer, for the day-to-day management of the Council's treasury management activities. The Treasury Management Strategy for 2004/05 details the expected activities for the team in the coming financial year and has been produced in accordance with the Council's approved Treasury Management Policy Statement.
- 1.2 The 2003 Prudential Code for Capital Finance in local authorities has introduced new requirements for the manner in which capital spending plans are to be considered and approved, and in conjunction with this, the development of this integrated Treasury Management Strategy.
- 1.3 The Treasury Management Strategy covers the:
- Current treasury portfolio position
  - Treasury limits for 2004/05
  - Prudential indicators for 2004/05 – 2006/07
  - Prospects for the economy and interest rates
  - Borrowing strategy
  - Investment strategy
  - Debt rescheduling opportunities

#### 2. CURRENT TREASURY PORTFOLIO POSITION

- 2.1 The Council's treasury portfolio position as at 31 December 2003 is as follows:

<b>DEBT POSITION</b>	<b>Principal (£)</b>	<b>Average Rate (%)</b>
Public Works Loan Board	53,259,920	5.68
<b>Total Debt</b>	<b>53,259,920</b>	

Estimated Borrowing Requirement for 2004/05 – supported borrowing approvals of approximately £15,800,000, plus the potential for an additional £5,000,000 unsupported borrowing under the Prudential Code, which includes £1,800,000 borrowing already approved by Members.

<b>INVESTMENT POSITION</b>	<b>Principal (£)</b>	<b>Average Rate (%)</b>
Internally managed funds	27,390,000	3.88
Externally managed funds	6,759,307	2.34
<b>Total Investments</b>	<b>34,149,307</b>	

**Note:**

Total investments will decline sharply in the last three months of the financial year as capital projects near completion.

**3. TREASURY LIMITS FOR 2004/05**

- 3.1 It is a statutory duty under Section 3 of the Local Government Act 2003, and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit".
- 3.2 The Council must have regard to the Prudential Code when setting its Affordable Borrowing Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax levels is 'acceptable'.
- 3.3 Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate those planned to be financed by both external borrowing and other forms of liability, such as credit arrangements. The affordable borrowing limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

**4. TREASURY MANAGEMENT PRUDENTIAL INDICATORS FOR 2004/05 – 2006/07**

- 4.1 The following prudential indicators are relevant for the purposes of setting an integrated Treasury Management Strategy.

<b>PRUDENTIAL INDICATOR</b>	<b>2003/04</b>	<b>2004/05</b>	<b>2005/06</b>	<b>2006/07</b>
<b>1 Affordable Borrowing Limit</b>	<b>£ p</b>	<b>£ p</b>	<b>£ p</b>	<b>£ p</b>
Increase in council tax (Band D, per annum)				
Previously agreed Prudential Borrowing re the North Herefordshire Pool.	N/A	1.35	2.73	3.01
Position if £5,000,000 Prudential Borrowing is taken for 2004/05.	N/A	3.75	7.06	7.34
Position if £5,000,000 Prudential Borrowing is taken for 2004/05 and subsequent years.	N/A	3.75	10.52	17.28

<b>PRUDENTIAL INDICATOR</b>	<b>2003/04</b>	<b>2004/05</b>	<b>2005/06</b>	<b>2006/07</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
<b>2 Capital Financing Requirement (as at 31/3)</b>				
Total	<b>78,090</b>	<b>94,892</b>	<b>111,063</b>	<b>126,538</b>
<b>3 Authorised Limit for External Debt</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Borrowing	105,000	119,000	142,000	163,000
Other Long Term Liabilities	1,500	3,000	3,000	3,000
Total	<b>106,500</b>	<b>122,000</b>	<b>145,000</b>	<b>166,000</b>
<b>4 Operational Boundary</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Borrowing	63,000	73,500	94,500	115,500
Other Long Term Liabilities	1,500	1,500	1,500	1,500
Total	<b>64,500</b>	<b>75,000</b>	<b>96,000</b>	<b>117,000</b>
<b>5 Upper Limit for Fixed Interest Rate Exposure</b>	<b>£ or %</b>	<b>£ or %</b>	<b>£ or %</b>	<b>£ or %</b>
Net principal re fixed rate borrowing / investments	100%	100%	100%	100%
<b>6 Upper Limit for Variable Interest Rate Exposure</b>	<b>£ or %</b>	<b>£ or %</b>	<b>£ or %</b>	<b>£ or %</b>
Net principal re variable rate borrowing / investments	25%	50%	50%	50%
<b>7 Maturity Structure of new fixed rate borrowing during 2004/05</b>	<b>Upper Limit</b>	<b>Lower Limit</b>		
Under 12 Months	30%	0%		
12 months and within 24 months	60%	0%		
24 months and within 5 years	90%	0%		
5 years and within 10 years	100%	0%		
10 years and above	100%	20%		
<b>8 Upper Limit for total principal sums invested for over 364 days</b>	<b>2003/04</b>	<b>2004/05</b>	<b>2005/06</b>	<b>2006/07</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
(per maturity date)	7,000	10,000	10,000	10,000

## 5. PROSPECTS FOR THE ECONOMY & INTEREST RATES

- 5.1 The Council retains Sector Treasury Services Limited as its treasury advisers and part of its service is to assist in forming a view on economic trends and the effect on interest rates. This section of the strategy outlines the Council's view of the economy and interest rates based on the advice of its treasury advisers.

### The Economy

- 5.2 **Shorter term rates** - Base rate was cut by 0.25% in July 2003, to a new 48-year low of 3.50% owing to hesitant recovery after the Iraq war and a climbing pound. With hindsight, this now appears to have been an over-cautious move as this cut was reversed in November 2003. However, the Chancellor announced a switch of inflation target for the Monetary Policy Committee (MPC) in the Pre Budget Report in December 2003 from plus or minus 1% around 2.5% on RPIX (Retail Prices Index excluding mortgages) to plus or minus 1% around 2% on CPI (consumer prices index). CPI has been running at 1.1–1.6% throughout 2003 and is forecast to average 1.4% in 2003, 1.7% in 2004 and 1.4% in 2005 i.e. below the likely target. In addition, wage inflation and producer price inflation are running at benign levels and oil prices are likely to come down from current high levels.
- 5.3 There is, therefore, likely to be little inflationary pressure to raise base rate. In addition, the potential for base rate to increase is limited by the heightened sensitivity of consumers to interest rate rises owing to the huge increase in personal borrowing in recent years and increase in base rate from 3.5% to 4.5% is an increase of 29% in likely borrowing rates. In view of the likely fragility of consumer demand in 2004 and in the UK, and owing to the likelihood of growth in the US falling back in 2004 to only a modest rate and weak growth expected in the Eurozone in 2004, it is expected that base rate will only rise to 4.25% by the end of 2004 after being at 4.0% for most of the year.
- 5.4 **Longer-term interest rates** – PWLB rates were at low levels during the first half of 2003 owing to investor fears over the Iraq war which depressed share values and gilt yields. Equity values have increased by about 25-30% from the low point to which they plummeted before the Iraq war, on expectations that the surge in economic recovery in the second half of 2003 will last well into 2004 and beyond and so boost corporate earnings.
- 5.5 Gilt prices have consequently fallen, causing increases in gilt yields and long-term PWLB rates which incurred a sharp unexpected increase in October 2003 on a surge in optimism on US economic recovery. This pushed the PWLB 20-25 year lower quota rate up to 5.00%-5.15% and it is forecast that this rate will stabilise around 5.00% for most of 2004/05. A rise in long-term PWLB rates to more normal levels with the 20-25 year lower quota rate returning consistently to the band of 5.00%-5.40% looks likely in 2004/05.

## Interest Rates

- 5.6 Having set the scene in economic terms, the likely impact for interest rates can be assessed and is illustrated in the following tables.

**Table 1 Sector Treasury - Interest Rate Forecast**

(This table represents the view of the Council's Treasury advisors as at December 2003)

%	Current	Q1 2004	Q2 2004	Q3 2004	Q4 2004
<b>Base Rate</b>	3.75	4.00	4.00	4.25	4.25
<b>10 Year PWLB</b>	5.00	5.00	5.00	5.00	5.00
<b>25 Year PWLB</b>	4.90	4.75	5.00	5.00	5.00

**Table 2 Summary of Independent Forecasts of Base Rate**

(This table represents the views of 35 independent forecasters views of base rate as at November 2003)

%	2004 Year end	2005 average	2006 average	2007 average
<b>Average</b>	4.27	4.78	5.05	4.93
<b>Highest</b>	5.00	5.72	5.60	5.60
<b>Lowest</b>	3.14	4.00	3.81	3.84

**Table 3 Consensus Forecast on Short-term & 10 year Fixed Interest Rates as at November 2003**

(This table represents the views of 25 City institutions)

%		November 2003	February 2004	November 2004
<b>3 Month Interbank</b>	Average	3.88	3.70	4.10
	Highest	3.88	4.00	4.70
	Lowest	3.88	3.50	3.30
<b>10 Year PWLB Rate</b>	Average	5.20	4.85	4.95
	Highest	5.20	5.15	5.55
	Lowest	5.20	4.45	4.25

## 6. BORROWING STRATEGY

6.1 Based upon the prospects for interest rates outlined above, there are a number of strategy options available. The anticipation is that short-term variable PWLB rates will continue to be cheaper than long-term PWLB fixed rate borrowing during 2004/05. Short term variable rates are expected to rise in line with increases in base rate. Long term rates are not currently expected to move far, but if there were a major fall in share prices (which is not expected given the general expectations for world economic recovery), then long rates would be susceptible to a corresponding fall. These expectations provide a variety of options:

- That short term rates will be good value compared to long term rates, and are likely to remain so for potentially at least the next couple of years. Best value will, therefore, be achieved by borrowing short-term at variable rates in order to minimise borrowing costs in the short-term or to make short-term savings required in order to meet budgetary constraints.
- That Money Market debt will also be considered where opportunities are available to minimise borrowing costs in the short-term. These have recently become more attractive than PWLB rates and, therefore, the County Treasurer will carefully monitor the interest rates available and take advice from the Treasury Management Consultants over the timing of any new borrowing.
- That the risks intrinsic in the shorter term variable rates are such, when compared to historically relatively low long term fixed funding, which may be achievable in 2004/05, that the Council will maintain a stable, longer term portfolio by drawing longer term fixed rate funding at a marginally higher rate than short term rates.

6.2 Against this background, caution will be adopted with the 2004/05 treasury operations. The County Treasurer will monitor the interest rate market and adopt a pragmatic approach to any changing circumstances.

6.3 **Sensitivity of the forecast** - The main sensitivities of the forecast are likely to be the two scenarios below. Council officers, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of view:

- ***If it was felt that there was a significant risk of a sharp rise in long and short term rates***, perhaps arising from a greater than expected increase in world activity, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.
- ***If it was felt that there was a significant risk of a sharp fall in long and short term rates***, owing to e.g. growth rates remaining low or weakening, then long term borrowings will be postponed, and any rescheduling from fixed rate funding into variable or short rate funding will be exercised.

## **7. INVESTMENT STRATEGY**

### **Internally Managed Funds**

- 7.1 The County Treasurer manages part of the Council's investment portfolio. Investments managed by the in-house team are generally temporary in nature and short-term. All decisions are made in the light of the Council's forecast cash flow requirements.
- 7.2 If, during the course of the year, the County Treasurer detects that the market's expectation for base rates has been too high, the strategy will be to keep investments as long as possible with a view to locking in higher rates of return than may be available at a later stage when market expectations are corrected.
- 7.3 Investment returns are forecast to be less than the cost of new borrowing during most of the year; it may, therefore, be beneficial to finance new capital expenditure by running down cash balances.

### **Externally Managed Funds**

- 7.4 A cash fund of £6,759,307 (as at 31st December 2003) is managed by Investec Asset Management and the Council's treasury adviser assists in monitoring the cash fund manager's performance during the course of the year. Their performance will continue to be monitored in 2004/05.

## **8. DEBT RESCHEDULING OPPORTUNITIES**

- 8.1 With variable rate borrowing and fixed borrowing for short periods (e.g. one year) at rates below 4.50%, opportunities may exist for restructuring long-term debt into short term debt to produce savings. Fixed rates are not expected to rise back up to about 5.25% to 5.50% during 2004/05. Consequently long-term debt rates at or above 4.90% would warrant reviewing the potential for undertaking debt restructuring.
- 8.2 Money market debt will also be considered as part of debt rescheduling, where opportunities exist to replace high rated PWLB loans with lower rated market debt to produce interest savings over the short term (between one and four years). The County Treasurer will carefully monitor interest rates and take advice from the Treasury Management Consultants over the timing of any debt rescheduling.
- 8.3 Any positions taken via rescheduling will be in accordance with the strategy position outlined in paragraph 6 above. The reasons for any rescheduling to take place will include:
- The generation of cash savings at minimum risk
  - The borrowing strategy outlined above
  - A better balance in the maturity profile of the long-term debt portfolio
  - A better balance in the ratio of variable to fixed interest rate loans in the long-term debt portfolio.





## HEREFORDSHIRE COUNCIL

### TREASURY MANAGEMENT POLICY STATEMENT

#### Statement of Purpose

1. Herefordshire Council adopts the key recommendations of CIPFA's *Treasury Management in the Public Services: Code of Practice (2001)* and:
  - Will put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of its treasury management activities.
  - Will make effective management and control of risk the prime objectives of its treasury management activities.
  - Acknowledge that the pursuit of best value in treasury management, and the use of suitable measures of performance measures, are valid and important tools to employ in support of business and service objectives.
  - That, within the context of effective risk management, will ensure that its treasury management policies and practices reflect the pursuit of best value.
  - Formally adopts Section 5 of the Code.
  - Will adopt a treasury management policy statement as recommended in Section 6 of the Code.
  - Will follow the recommendations in Section 7 of the Code concerning treasury management practice statements.

#### Definition of Treasury Management

2. Herefordshire 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 control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.'*

#### Policy Objectives

3. Herefordshire Council regards the successful identification, monitoring and control of risk to 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 Council.
4. Herefordshire Council acknowledges that effective treasury management will provide support towards the achievement of its business and services 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.

## Delegation and Reporting

5. Herefordshire Council retains responsibility for the approving the Council's Treasury Management Policy and will consider amendments to it on the advice of Cabinet.
6. Herefordshire Council delegates responsibility for approving an annual Treasury Management Strategy to Cabinet as the mechanism for implementing the Treasury Management Policy.
7. Herefordshire Council delegates responsibility for monitoring that treasury management activity is in accordance with the approved policies, strategies and practices to Cabinet.
8. Herefordshire Council delegates responsibility for the development and maintenance of suitable Treasury Management Practices to the County Treasurer.
9. Herefordshire Council delegates responsibility for the administration of treasury management decisions to the County Treasurer who will act in accordance with the approved Treasury Management Policy Statement, Treasury Management Strategy and Treasury Management Practices. If the County Treasurer is a member of CIPFA, he/she shall also comply with CIPFA's Standard of Professional Practice on Treasury Management.
10. Herefordshire Council will receive reports from the County Treasurer on its treasury management policies, strategy, practices and activities, including, as a minimum, an annual strategy in advance of the year and an annual report after its close, in the form prescribed in the Council's Treasury Management Practices.