LANCASTER
CITY COUNCIL

Promoting City, Coast & Countryside

Committee: **BUDGET AND PERFORMANCE PANEL**

Date: **TUESDAY, 22 FEBRUARY 2011**

Venue: **LANCASTER TOWN HALL**

Time: **6.00 P.M.**

A G E N D A

1. **Apologies for absence**

2. **Appointment of Vice-Chairman**

3. **Declaration of Interests**

4. **Minutes**

   Minutes of the Meeting held on 25 January 2011 (previously circulated)

5. **Items of Urgent Business authorised by the Chairman**

6. **Corporate Review of Service Level Agreements** (Pages 1 - 7)

   Report of Head of Community Engagement.

   Copy of Cabinet report attached.

7. **Treasury Management Strategy 2011/12** (Pages 8 - 34)

   Report of Head of Financial Services.

   Copy of Cabinet report attached.

8. **Work Programme** (Pages 35 - 36)

   Report of Head of Governance.

ADMINISTRATIVE ARRANGEMENTS

(i) Membership

Councillors Roger Sherlock (Chairman), Evelyn Archer, Roger Dennison, Jean Dent, Keran Farrow, Emily Heath, Tony Johnson, Elizabeth Scott and 1 Green vacancy

(ii) Substitute Membership

Councillors Tina Clifford, Chris Coates, Karen Leytham, Roger Plumb, Peter Robinson, Sylvia Rogerson, Keith Sowden and Morgwn Trolinger

(iii) Queries regarding this Agenda

Please contact Tom Silvani, Democratic Services - telephone 01524 582132, or email tsilvani@lancaster.gov.uk.

(iv) Changes to Membership, substitutions or apologies

Please contact Members' Secretary, telephone 582170, or alternatively email memberservices@lancaster.gov.uk.

MARK CULLINAN
CHIEF EXECUTIVE
TOWN HALL,
LANCASTER LA1 1 PJ

Published on 14 February 2011

CABINET

Corporate Review of Service Level Agreements
15 February 2011

Report of the Head of Community Engagement

PURPOSE OF REPORT					
To provide members with an update and findings on a review into SLA's (Service Level Agreements), to recommend some short term actions to improve management arrangements and also the principles of an overall approach to the council's future arrangements for the efficient management of it's investment and support for external organisations, in order to maximise impact.					
Key Decision	X	**Non-Key Decision**		**Referral from Cabinet Member**	
Date Included in Forward Plan	28 January 2011				
This report is public					

RECOMMENDATIONS OF THE HEAD OF COMMUNITY ENGAGEMENT

(1) That the council extend existing SLA's at current 2010/11 funding levels for the financial year 2011/12 with the exception of the specific time limited agreement with Storey Creative Industries Centre (SCIC) which will end on 31st March 2011 and any SLA's that are supported by external funding tied to specific time periods and where relevant at a reduced level already agreed as part of the 2010/11 Budget Process, e.g. The Dukes

(2) That officers enter into discussions with County Council to consider the potential for future joint investment in the VCFS (Voluntary, Community and Faith sector), including a shared approach to monitoring and evaluation.

(3) That potential for shared administration arrangements is investigated in relation to the Council's Welfare Grants in order to achieve efficiency.

(4) That over the next 12 months, officers develop and bring forward proposals for a commissioning approach with the VCFS and other external organisations that will:

- **Maximise the impact of the council's investment**
- **To assist delivery of corporate priorities**
- **Provide appropriate support that will safeguard key services**

- **Develop the potential of the VCFS to deliver services in the district on behalf of the council.**

1.0 Background

1.1 The council currently manages somewhere in the region of 40 separate SLA's. Some of these (17 with a total value of £470,900) would normally lapse at the end of this financial year, however this report is recommending that those included in the Appendix to this report continue for a further year at current funding levels pending further review. This amount excludes those SLA's tied into longer contractual periods, external grant funded SLA's and SLA's relating to land assets, which are of a distinct nature and outside the scope of this report. Within the sector as a whole these SLA's fall into a number of natural groups such as Arts, Housing Support and Crime Prevention. Whilst this report focuses upon the council's SLA's, Cabinet will note there is a specific recommendation relating to the future administration of the council's Welfare Grants. At present the Welfare Grants represents a relatively small pot of money with restrictive criteria and as a result the impact is limited. However, a quick improvement can be achieved by dealing with the disproportionately heavy administration requirements and aligning the grants with other funds available in the district.

1.2 Partner organisations and funded bodies fully understand the financial pressures facing the council, and this national context presents an opportunity for the council to consider how best to maximise its investment in VCFS via SLA's

1.3 A recent review of the council's approach to SLA's revealed a number of issues which must be tackled to ensure that future investment is clearly focussed on our priorities and rigorously monitored to ensure desired outcomes are delivered.

2.0 Key Issues

2.1 The Council has not systematically agreed what it wishes to achieve overall from its investment in SLA's or what services it wishes to prioritise.

2.2 Within the Council there are some examples of good practice in terms of the management and monitoring of SLA's and there is an opportunity to spread this across the Council to create consistency and to use the experience gained to best effect

2.3 It is difficult to demonstrate that desired outcomes are delivered and fully understand what the council is getting in return for its investment, there is often no assessment of value for money provided

2.4 The current need for most VCFS organisations to bid into a number of 'pots' in order to survive can lead to organisations working in the same sector competing against each other rather than working together.

2.5 SLA'S currently tend to be automatically renewed without critical evaluation of effectiveness or benefits realised.

2.6 In some cases the council has a number of SLA's with a single organisation

2.7 Some organisations receiving SLA funding from the council are also in receipt of significant amounts of money from multiple funders. Visibility of global funding to a given organisation is an issue.

2.8 A great deal of officer time is spent in the administration of the Council's Welfare Grants whilst the grant fund is currently less than £4000 per annum.

It is likely that a cooperative arrangement with another grant funder may present opportunities to protect the benefits of the grants whilst reducing the administration costs.

3.0 Proposal Details

3.1 A number of actions are proposed in order to bring about improvement in the overall impact of the council's investment in SLA's and also to create consistent corporate standards for the management of SLA's in the future so that unnecessary administration costs for legal, financial and monitoring support are avoided, risks reduced and outcomes protected. Some straightforward proposals can be implemented immediately but this report also suggests some new approaches that will take some time to develop. These medium term improvements include more focus on investment linked to corporate priorities, joint investment and more efficient management arrangements by working with County Council and also the development of a commissioning framework that will also support the principles of collaborative working by the council's partner organisations. In detail the proposals are as follows:

3.2 Extend existing SLA's at current funding levels for the financial year 2011/12 with the exception of one specific time limited agreement with Storey Creative Industries which will end on 31st March 2011 and any SLA's that are externally funded for a specific time period. This will give the council time to come to a considered view as to what it wishes to achieve from its overall investment in SLA's, in line with corporate priorities and without unintended consequences. As a result future funding should be more targeted at priorities, have a clearer impact and be allocated in a way that seems fair and transparent. It is recommended that proposals are developed to establish clear principles and criteria as a framework for investment decisions to ensure that the council's investments are transparent and targeted towards achieving priorities.

3.3 The development of a clear and consistent corporate management framework, to be implemented from 1 April 2011 onwards, will significantly improve the day to day management and monitoring of existing SLA's, ensuring that best practice approaches which currently exist are shared across the authority.

3.4 Officers to begin dialogue with the County Council to investigate opportunities to better work together in the funding and management of SLA's. Both councils routinely provide funding to the same organisations and separately monitor and evaluate the delivery of commissioned services. This presents a clear opportunity to reduce duplication and simplify the funding of VCFS organisations.

3.5 Officers to also investigate the potential to create efficiency in the management of the Council's Welfare Grants scheme, including investigation of a possible shared administration arrangement with other grant funders.

3.6 A further report to be presented to Cabinet which develops specific and detailed proposals for a framework for future investment primarily linked to Corporate Priorities. The following will be considered:

- An assessment of the opportunities and the advantages /disadvantages of providing future support to specific sectors rather than to individual organisations
- The support that may be required for the development of collaborative arrangements between external partners to work together to jointly deliver services in an efficient and effective way.

- The development of a formal commissioning approach that will provide a corporate framework for consistent and effective management of the council's investment in return for delivery of priority services by external partners, linked to clearly defined outcomes

4.0 Details of Consultation

4.1 In preparing this report, the council has consulted with all organisations currently funded via SLA's and their views have been taken into consideration in the development of this report. Feedback from the consultation focused on the importance of the funding brought in by SLA's, particularly in terms of how these brought in further match funding in order to achieve service delivery and also the impact of the work carried out through supported services in the local area.

5.0 Options and Options Analysis (including risk assessment)

	Option 1: Agree Recommendations	**Option 2:** Do Nothing
Advantages	Potential for a much higher impact as a result of the council's investment. Opportunity for possible savings in the future without loss of services Efficiency achieved as a result of more consistent corporate management arrangements Increased impact and efficiency achieved by potential joint investment and shared management arrangements.	Will not require significant investment in officer time.
Disadvantages	Development of a consortium approach by sector will require significant investment of officer time in the early stages although has the potential to create efficiency later.	The council could fail to maximise its investment in VCFS and other external organisations and there is continuing inefficiency and duplication in both funding and administration.
Risks	New ways of working may take some time to develop and partners may need some support to build capacity given that not all organisations are at the same level of maturity. Collaborative working arrangements may be difficult to achieve in some cases.	The council could appear inconsistent in the manner in which it provides support to VCFS and other external organisations.

	Officer time spent on development of proposals is not available for other activities.	

The preferred option is Option 1.

6.0 Conclusion

The review of Service Level Agreements has highlighted a number of issues as detailed in this report. However, there is no doubt that many of the services currently funded by the council via its SLA's are valuable and have an impact on our local communities. Whilst this report suggests some immediate actions that can lead to fairly quick overall improvements, there is an opportunity to look further ahead and to prepare for some more significant changes in the medium term future. This work will take longer to develop but could allow the council to be better placed in the future to achieve more from its investments, to have the management tools necessary to support key services through a commissioning framework and to be able to support external partners to develop the collaborative approaches they will need in the years to come. The report therefore recommends that the current investment in SLA's is maintained whilst the work required to develop the medium term proposals is undertaken. Future reports to Cabinet will provide further information on the proposed approaches.

RELATIONSHIP TO POLICY FRAMEWORK

This report is consistent with current corporate priorities and the continuation of these as agreed by Cabinet at its meeting on the 9 November 2010 and which will be sent to Council for consideration, reinforced the following principles:

- Partnership working and Community Leadership – working with partners to reduce costs, make efficiencies and create resilience within the district.
- That Cabinet notes the intention to protect the most vulnerable in our society should also be a thread that runs through all our priorities.

CONCLUSION OF IMPACT ASSESSMENT
(including Diversity, Human Rights, Community Safety, Sustainability and Rural Proofing)

The proposals and recommendations of these reports do not have much immediate impact as they largely refer to future working arrangements and the impact of these would be presented in due course depending on the agreed approach. In terms of the current SLA's then these contribute to many of the strands of the Sustainable Community Strategy on issues including community safety and valuing people with groups from across the CVFS having existing SLA's.

LEGAL IMPLICATIONS

The contractual arrangements of SLA's with external organisations would need to be improved and this has being discussed informally already with legal staff within the Governance Service. Their involvement would be crucial to developing such agreements in the future.

FINANCIAL IMPLICATIONS

The 2011/12 draft budget currently assumes inflationary increases of 2.4% for all city council funded SLA's, therefore if the recommendation to freeze such grants at 2010/11 levels is agreed there will be a saving of £10.5K.

Members are reminded that funding for the Dukes is less in 2011/12 compared to the current year as a result of budget decisions made during the 2009/10 and 2010/11 processes.

Members are also reminded that although LCC grant funding to the SCIC will cease on 31st March 2011, there will still be ongoing monitoring requirements in future years arising from output evidence to be achieved as per previous external grant conditions for which the council has acted as accountable body for. There will also be ongoing annual related company reporting requirements for the council as it has a nominated Member on the SCIC board acting as liaison between the SCIC and ourselves.

Ongoing review and monitoring of SLA's by the Partnerships Team will continue to be undertaken in conjunction with ongoing support from Financial Services and Legal Services where appropriate.

OTHER RESOURCE IMPLICATIONS

Human Resources:

Alternative management arrangements for Welfare Grants would result in a reduction in the administration burden for Democratic Services staff to a level which would be in line with their current staffing levels, following the recent restructure.

Option 1 requires a significant investment in officer time to bring about the changes proposed.

Information Services:

There are no specific Information Services implications arising from this report.

Property:

There are no specific Property implications arising from this report.

Open Spaces:

There are no open space implications arising from this report.

SECTION 151 OFFICER'S COMMENTS

As outlined in the financial implications, the recommendations would provide for some savings from 2011/12 onwards and the s151 Officer would advise that these be considered in context of the Council's priorities and its future financial prospects, as well as the need to achieve value for money.

MONITORING OFFICER'S COMMENTS

The Monitoring Officer has been consulted and has no further comment.

BACKGROUND PAPERS	
Appendix A to the report.	**Contact Officer:** Anne Marie Harrison **Telephone:** 01524 582308 **E-mail:** amharrison@lancaster.gov.uk

Appendix A

Lancaster City Council - SLA's due to expire 31st March 2011 but recommended to extend until 31st March 2012

SLA Agreement	2010/2011 Revised Budget £	2011/12 Base Budget £	2011/12 Inflation £	Draft Budget 2011/2012 £	
Dukes Playhouse	148,600	**140,600**	3,100	**143,700**	**1**
Morecambe Music Residency	10,200	**10,200**	200	**10,400**	
Ludus	22,200	**22,200**	200	**22,400**	
Lcr Literature Festival	9,200	**9,200**	200	**9,400**	
Friends Of Storey Inst.	10,400	**10,400**	200	**10,600**	
Council for Voluntary Service Grant	15,500	**15,700**	400	**16,100**	
One Voice Grant	6,000	**6,000**	100	**6,100**	
Rainbow Centre, Mcmbe	5,000	**5,000**	100	**5,100**	
Age Concern, Lancs	7,500	**7,500**	200	**7,700**	
Lcstr District Samaritans	1,500	**1,500**	0	**1,500**	
Thumbprints	4,100	**4,100**	100	**4,200**	
Citizens Advice	172,800	**172,800**	4,100	**176,900**	
Shopmobility	12,300	**12,300**	300	**12,600**	
Victim Support Scheme	5,000	**5,000**	100	**5,100**	
Relate (Rent Free Accomm)	6,800	**6,800**	200	**7,000**	
Marsh Community Centre Lancaster YMCA - Ridge Community Centre	41,600	**41,600**	1,000	**42,600**	
Total	**478,700**	**470,900**	**10,500**	**481,400**	

Note:

1. The base budget for the Dukes reduces in 2011/12 compared to 2010/11 as per decisions made during the 2009/10 & 2010/11 budget cycles.

Budget and Performance Panel

Treasury Management Strategy 2011/12
22 February 2011

Report of Head of Financial Services

PURPOSE OF REPORT

To seek the Panel's views regarding the treasury management framework proposals for next year, prior to them being considered by Council.

This report is public

RECOMMENDATIONS

1. **That Budget and Performance Panel considers the attached Treasury Management progress report and draft framework documents for 2011/12 and makes recommendations as appropriate.**

1 **Introduction**

1.1 At its meeting on 15 February Cabinet will consider the attached report, including the treasury management framework proposals for 2011/12. In line with the updated (2009) CIPFA Treasury Management Code of Practice, Budget and Performance Panel have been explicitly named as responsible for scrutiny of the Treasury Management function, including review of the Annual Strategy.

1.2 Given the timing of Budget and Performance panel meetings, unfortunately it has not been possible to provide for scrutiny of the treasury proposals prior to them being considered by Cabinet. However, any recommendations arising from this Panel meeting will be fed into Budget Council on 02 March, when Members will be asked formally to approve the framework.

CONCLUSION OF IMPACT ASSESSMENT **(including Diversity, Human Rights, Community Safety, Sustainability and Rural Proofing)** As set out in the attached report.	
FINANCIAL IMPLICATIONS As set out in the attached report.	
LEGAL IMPLICATIONS As set out in the attached report.	
S151 and MONITORING OFFICER'S COMMENTS As set out in the attached report.	
BACKGROUND PAPERS None.	**Contact Officer: Nadine Muschamp** **Telephone: 01524 582122** **E-mail: nmuschamp@lancaster.gov.uk** **Ref:**

CABINET

Treasury Management Strategy 2011/12
15 February 2011

Report of Head of Financial Services

PURPOSE OF REPORT					
This report sets out the position regarding the 2011/12 to 2013/14 Treasury Management Strategy for Cabinet's approval.					
Key Decision	✓	**Non-Key Decision**		**Referral**	
Date Included in Forward Plan	February 2011				
This report is public.					

RECOMMENDATIONS OF COUNCILLOR LANGHORN:

1. **That the monitoring report as set out at Appendix A be noted and referred on to Council for information.**

2. **That Council be recommended to approve the Treasury Management Strategy for the period 2011/12 to 2013/14 as set out in Appendix B, incorporating the Investment Strategy and Treasury Management Indicators, and as updated for Cabinet's final budget proposals.**

1 INTRODUCTION

1.1 It is a requirement of the CIPFA Code of Practice on Treasury Management ("the Code") that a strategy outlining the expected treasury activity for the forthcoming 3 years is adopted, but that this be reviewed at least annually. The proposed Treasury Management Strategy for the period 2011/12 to 2013/14 needs to cover the following forecasts and activities:

- the current treasury position
- expected movement in interest rates
- the borrowing and debt strategy
- the investment strategy
- specific limits on treasury activities
- treasury management indicators (previously reported as prudential indicators).

1.2 Further to the difficulties experienced in the Icelandic banking collapse and the wider banking crisis generally, the Code was updated in November 2009 and implemented in the 2010/11 Strategy. Both the Code and investment guidance issued by Government still remain flexible in order to cater for different public sector organisations and their differing operating arrangements, circumstances and risk appetites. Proposals regarding the various aspects of this authority's treasury management framework are set out below for Cabinet's consideration, although these would need to be updated should there be any changes to Cabinet's final budget proposals. The treasury framework, as updated, will be referred on for approval at Budget Council on 02 March 2011.

1.3 One of the changes introduced under the updated Code was that as well as receiving an outturn report on treasury performance, Council should also receive a mid-year update. In line with this principle, a summary of the latest monitoring report is included at ***Appendix A*** for information and referral on to Council.

1.4 In terms of Member training, the last formal session was held in September 2009. As demand was low, and treasury activity over the last year has been very low risk, it is not intended to undertake any further formal sessions until after the local elections. Very recently the Audit Committee indicated their support for this approach but training can be provided in the interim if Members require it.

2 TREASURY MANAGEMENT STRATEGY

2.1 The proposed Treasury Management Strategy for 2011/12 to 2013/14 is set out at ***Appendix B*** for Cabinet's consideration. This document contains the necessary details to comply with both the Code and Government investment guidance. Responsibilities for treasury management are set out at ***Appendix C***. A single document covering the Treasury Management Strategy and the Investment Strategy is to be approved by Council.

2.2 Key elements and assumptions feeding into the proposals are outlined below. These take account of Cabinet's existing budget proposals. Should there be any changes to the budget, then the treasury framework would need to be updated accordingly.

2.3 Borrowing Aspects of the Strategy

2.3.1 Based on the draft budget, the physical borrowing position of the Council is projected to remain constant over the next three years. This assumes that the Council will benefit from capital receipts linked to the sale of land at South Lancaster. The position on Iceland is also far from certain although essentially the worst case scenario was provided for in the prior year accounts. The resolution of Luneside East land acquisition is also still a material uncertainty. Another potential factor relates to managing any redundancy costs arising from any future staffing reductions, as the Council takes action to balance its medium term budget forecasts. The Council may choose to manage these through its proposed Restructuring reserves, but depending on affordability, it may seek capitalisation directives that could give rise to further borrowing pressures.

2.3.2 The above points represent major assumptions and depending on their outcome, the debt strategy may need to vary greatly from that attached. There is also the potential for a significant net impact on revenue, through associated increased interest charges or lost investment income, and making minimum revenue provisions (MRP) for any additional debt repayment. Cabinet's proposals in respect of the General Fund Capital Programme are most likely to affect this element of the Strategy.

2.3.3 Even more significant, however, is the planned implementation of self-financing for council housing from April 2012. These reforms are covered in the Localism Bill and information on the methodology has now been received from Government. To give context, in broad terms the proposals may involve the Council taking on around £30M debt, potentially, in return for the housing subsidy system (and the obligation to pay negative subsidy) being withdrawn.

2.3.4 At this point though, as the proposals for these reforms are still going through Parliament, the proposed Strategy does not provide for the impact of these potential changes. A revision of the Strategy will need to be considered by Cabinet and Council in due course, once the legislative position is clearer.

2.4 **Investment Aspects of the Strategy**

2.4.1 The current strategy follows on from previous, "post Iceland" strategies. It still represents a marked step back in terms of the perception of 'risk' from the position a few years ago. Several changes were introduced post Iceland to reduce counterparty risk in relation to investments. These included reducing limits both in terms of deposit length and amount, increasing the use of the Government's Debt Management Accounts Deposit Facility (DMADF), and excluding forward deals.

2.4.2 Although the financial sector has remained relatively stable over the last 12 months, following the General Election public services are facing budget cuts of such a scale and there are views that that there could potentially be serious, adverse, knock on effects to the wider economy. Similar issues also face a number of other EU countries such as Ireland, Greece, Portugal and Spain. Overall, this means that there is no strong argument for significant relaxation of the measures taken post Iceland as there is still a great deal of uncertainty over the direction of the economy, and therefore risk to the banking sector. There is the need, however, to ensure sufficient flexibility in managing investments without undermining security, and to ensure that risk appetite is appropriate.

2.4.3 Accordingly, the main changes to investment limits for 2011/12 onwards include some increases to the proposed limits with banks that meet investment criteria. This reflects the vastly reduced counterparty list of quality institutions that the Council can trade with, but also retains a strong link between investment amounts and the length of deposit with higher value deposits being held only on instant access. This will allow the Council to utilise more fully the value present in instant access call accounts and money market funds, without reducing credit criteria or liquidity. In addition the time limit for upper tier banks has been increased to 1 year but on a maximum deposit of £2M (see table 4, ***Appendix B***) to allow the Council to take advantage of the increased yields (see 2.4.6 below), where it is judged that adequate security and liquidity are not being sacrificed.

2.4.4 Under the Code, it is crucial that training is provided to help ensure that both Members and Officers have the necessary skills to fulfil their respective responsibilities. This area will continue to feature in the Member Development Strategy as well as Officer related training programmes. Member development will be considered by the Council's Business Committee after the local elections.

2.4.5 Overall, the strategy put forward follows on from 2010/11 in that it is based on the Council having a low risk appetite, with a focus on highly liquid, high quality deposits. The Code encourages greater involvement from Members in terms of setting benchmarks for risk, above those set down in investment strategy and Treasury Management Indicators. This is to be taken forward after the local elections. The development of benchmarking should help Members in future to set the strategic framework for Treasury Management, allowing for a more sophisticated method of setting the level of risk that is judged to be acceptable.

2.4.6 At present, given very low interest rates, the opportunity cost attached to a low risk strategy is considered to be small. However, the markets are starting to offer significantly improved rates for longer term deposits with rates of 1.5% for a 12 month deposit rising to 2.3% for a 2 year deposit. This is in comparison to 0.75% being the Council's best instant access account and 0.25% being the prevailing rate on the

DMADF account. Having said this, many of the instant access investments are linked to the bank rate so a low risk, high liquidity strategy will still benefit from an increase in interest rates. Although the margins between short and long term deposits may increase; the Council should avoid defaulting to an overly cautious approach and should look to ways, such as through the use of security and liquidity benchmarks, to manage risk effectively whilst improving slightly its investment returns.

2.4.7 It is stressed in terms of treasury activity, there is no risk free option. It is felt, however, that the measures set out above provide a sound framework within which to work over the coming year.

3 CONSULTATION

3.1 Officers have liaised with Sector, the Council's Treasury Advisors, in developing the proposed Strategies.

3.2 The proposals are also to be considered by Budget and Performance Panel at its meeting on 22 February 2011 and any recommendations arising will be fed directly into Budget Council.

4 OPTIONS AND OPTIONS ANALYSIS

4.1 As part of the adoption of the CIPFA Code of Practice on Treasury Management (2009) it is a statutory requirement that the Authority has a Treasury Management Strategy Statement and Investment Strategy. In this regard, Cabinet may put forward alternative proposals or amendments to the proposed documents, but these would have to be considered in light of legislative, professional and economic factors, and importantly, any alternative views regarding the Council's risk appetite. As such, no further options analysis is available at this time.

4.2 Furthermore, the Strategies must fit with other aspects of Cabinet's budget proposals, such as investment interest estimates and underlying prudential borrowing assumptions, feeding into Prudential and Treasury Management Indicators. It should be noted that the Prudential Indicators are also covered in the Budget report elsewhere on this agenda.

5 OFFICER PREFERRED OPTION AND JUSTIFICATION

5.1 The Officer Preferred Options are as reflected in the recommendations to this report. This is based on the Council continuing to have a low risk appetite regarding investments, and it takes into account the requirements of the Code.

RELATIONSHIP TO POLICY FRAMEWORK

This report is in accordance with the Council's Treasury Management Policy, and fits with the development of the Medium Term Financial Strategy. As well as approving the Strategy Council will be requested to re-approve the Policy Statement, as it does every year.

CONCLUSION OF IMPACT ASSESSMENT
(including Diversity, Human Rights, Community Safety, Sustainability etc)

No direct implications arising.

FINANCIAL IMPLICATIONS

None directly arising. The Strategy is in support of achieving the borrowing cost and investment interest estimates included in the draft base budget, based on a low risk approach.

SECTION 151 OFFICER'S COMMENTS

This report and its content forms part of the S151 Officer's responsibilities.

LEGAL IMPLICATIONS

Legal Services have been consulted and have no observations to make regarding this report; there are no implications directly arising.

DEPUTY MONITORING OFFICER'S COMMENTS

The Deputy Monitoring Officer has been consulted and has no further comments.

BACKGROUND PAPERS CIPFA Code of Practice	**Contact Officer: Nadine Muschamp** **Telephone:01524 582117** **E-mail:nmuschamp@lancaster.gov.uk**

Appendix A

2010/11 Treasury Management Progress Report to 31 December 2010

Report of Head of Financial Services

1. Introduction

Council approved the Treasury Strategy including the Investment Strategy for 2010/11 at its meeting on 03 March 2010. This report outlines activities undertaken in pursuance of those strategies during the financial year up to the end of quarter 3.

2. Summary

- During the quarter there has been a further repayment from KSF of £163K, bringing the total to £1,084K representing 53% of the claim. The Council's creditor status for Glitnir and Landsbanki is still awaiting judgement from the Icelandic courts with test cases due to be tried during March and February 2011. The results of these will give a strong indication of the outcome of the Council's claims.

- Regarding investment interest to 31 December there has been £74K of cash interest on investments with £137K of 'accounting' interest on Icelandic investments. This is in line with the revised budget for 2010/11.

- On other treasury matters there have been no changes to the debt portfolio. No temporary borrowing was required during the quarter, no new long term debt has been taken on and there has been no opportunity for repayment of existing loans. PWLB have put their rates up by 1% across the board which may alter their position in the market should the Council need to take on new loans, for example due to the forthcoming dismantling of the HRA subsidy system.

- There have been no material breaches of any prudential indicators or counterparty limits in the quarter and no other major risks have been identified.

3. Icelandic Investments Update

Regarding Icelandic investments, there is little new information from that reported as part of the 2009/10 outturn. During quarter 3 a further payment of £163K was received from KSF. This means that there is £940K still outstanding of the £2M invested, bringing total recoveries to 53%.

The legal action regarding preferential creditor status in relation to the Landsbanki and Glitnir investments (totalling £4M) is still underway in the Icelandic Courts. The Council continues as a party to the joint arrangements with other local authorities, organised through the Local Government Association and using Bevan Brittan which is judged to be both maximising the chance of a successful outcome and excellent value for money.

The test cases for Landsbanki and Glitnir are due to be heard in the Icelandic courts in February and March 2011. The outcome of these cases should give a strong indication of the outcome of the Council's claims.

4. Debt Portfolio

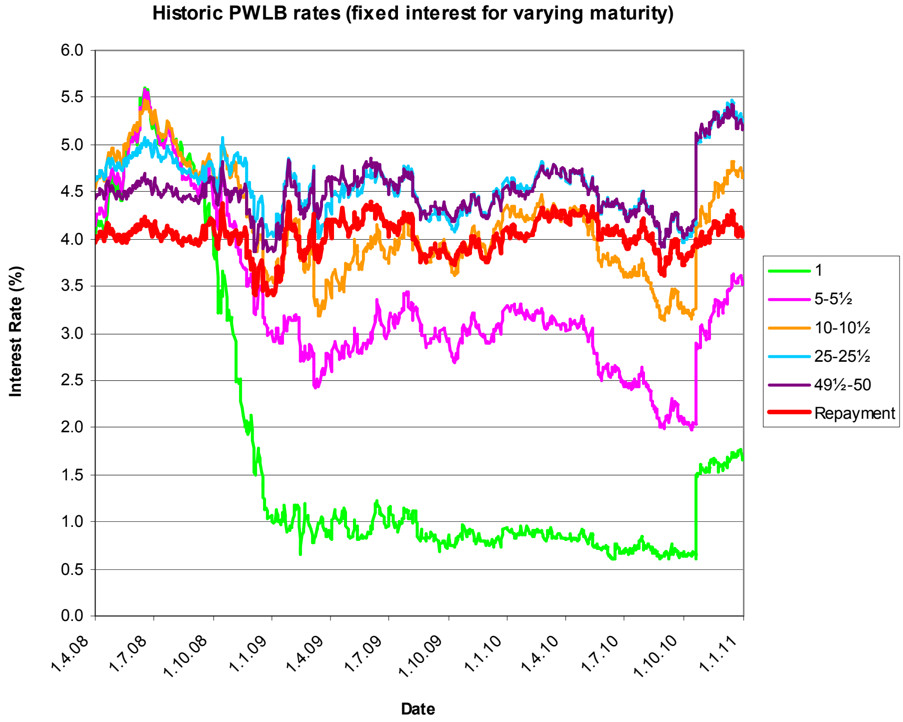
There has been no change to the long term debt portfolio since January 2009 and there is no immediate need to take out new long term loans. The Council's cash flow position remains strong, which is primarily because of the amounts being set aside each year from the budget for the future repayment of debt, through the Minimum Revenue Provision (MRP). Officers continue to monitor PWLB repayment rates for opportunities to reduce the outstanding debt balance without incurring early repayment penalties; the current position is reviewed in detail in section 5 below.

Some large schemes within the capital programme are now commencing (works at Lancaster and Morecambe town halls) however, there is likely to be significant slippage into 2011/12, any re-profiling and the implications on capital financing of this and any other additions or changes to the rolling 5 year programme will be reported through budget reports to Members. Luneside East compensation settlements, receipts from South Lancaster and the longer term liability linked to municipal buildings are still significant uncertainties which could impact on the debt position.

5. Current Borrowing Rates

The graph below shows that the pattern seen since January 2009 has persisted, with a marked spread between short term and long term borrowing. The main feature is the jump in rates across the board on the 20th October 2010 when central government added 1% to the cost of borrowing through the PWLB. This may have a significant impact in the future if the Council has to take on new debt through the review of the Housing Revenue Account Subsidy (HRAS) system. The repayment threshold has not been increased meaning that any new loans taken on would be less likely to be repayable early without incurring penalties. Together, these reduce the attractiveness of the PWLB as a lender and a thorough review of the market will be required for any new debt.

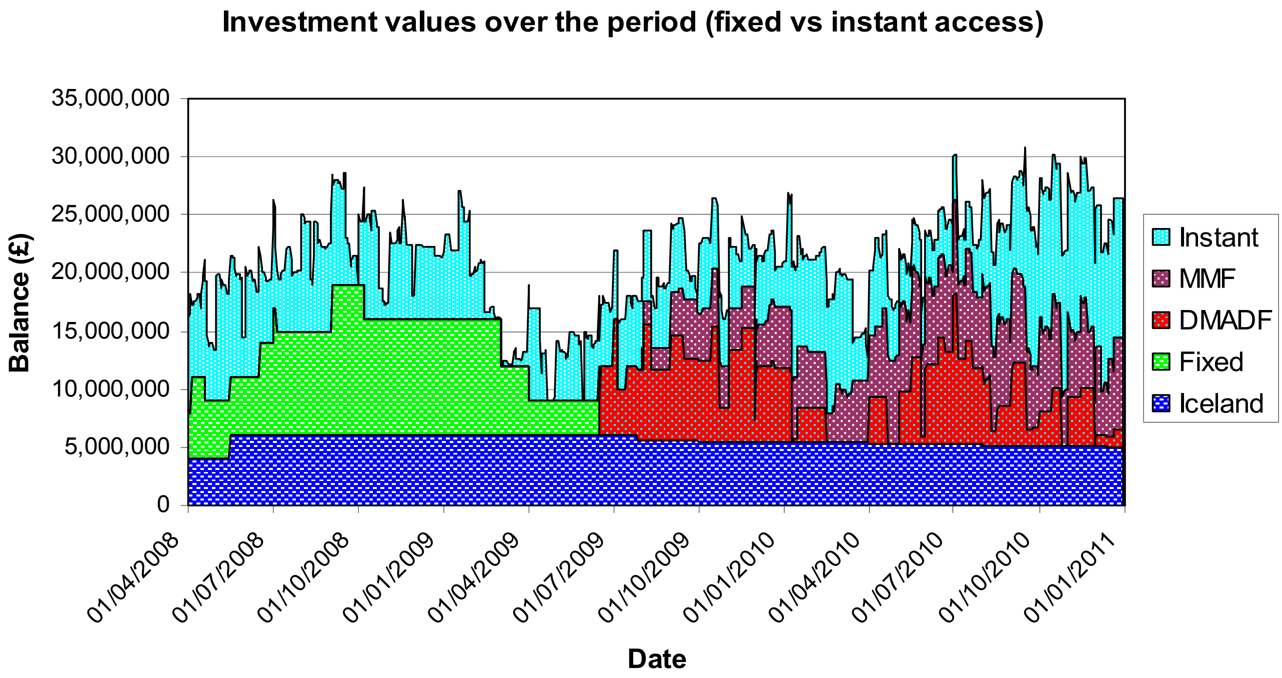
In relation to existing debt, the Council's cheapest major loan is at 4.6%; only when the repayment rate rises to 4.6% could we repay early without penalty and as can be seen from the graph the early repayment rate is still well below the level at which no penalty would be incurred, currently fluctuating around the 4% level.



6. Investing Activities

As laid down in the approved Investment Strategy, the aim is to prioritise security and liquidity of the council's investments. This is to ensure that the Council has sufficient cash to support its business, but also to minimise any further chance of a counterparty failing and the Council not being able to remove its deposits, as happened with the Icelandic banks.

All investment activity has been in line with the approved Treasury Strategy for 2010/11. No fixed term investments have been placed since September 2008, with the exception of Debt Management Accounts Deposit Facility (DMADF) deposits (i.e. with HM Government). Any other surplus cash has been managed on a day to day basis using the call accounts and Money Market Funds (MMF). A full list of the investments at the end of quarter 3 is enclosed at ***Appendix A1.*** Towards the end of quarter 2, the Council had brought the Santander Call account back into use following relaxing of concerns around its credit worthiness. In addition, there has been a full quarter of using the County Council Call account. These factors combined have helped to reduce the number of deposits in the DMADF and have allowed both improved liquidity and improved returns without loss of security.



7. Summary of Budget Position and Performance

In terms of performance against external benchmarks, the return on investments compared to the LIBID and bank rates over the year to date is as follows:

Base Rate	0.50%
3 Month LIBID	0.72%
Lancaster CC investments	0.51%

The return is just above base but well below 3 month LIBID. The Council has focussed on secure and highly liquid deposits. This is a slight improvement on quarter 2 (4.6%) due to increased use of the Santander Call account and the County council facility. The portfolio is still spread over a variety of investments with DMADF (0.25%) and governmental money market fund (0.39%) both paying below Bank rate but still forming a core of the balances invested.

The approved Investment Strategy also allows for fixed term deposits up to 1 year with other local authorities, which means that the Council could take advantage of the County Council's fixed term investment offer that would match the market rate. This would pay a significant margin over the instant access rates albeit at the expense of liquidity. Current market rates for a 12 month deposit are in the region of 1.5% (as per Sector investment monitor).

In terms of performance against budget, the details are as follows:

Annual budget	£254K (revised)	
Evenly profiled budget	£191K	
Actual to date	£74K	(see details in ***Appendix A1)***
"Icelandic" to date	£137K	(see details in ***Appendix A1)***
Total	£211K	
Variance	£20K	

Although investment interest is showing a positive variance against the evenly profiled budget, it is expected that investment balances will drop off in the final quarter of the year as Council tax and NNDR income fall away after January. The revised annual budget is the expected out-turn. This takes into account both the ‘real’ interest from active external investments as well as the ‘accounting’ interest applied to Icelandic investments that have defaulted, as per the accounting regulations.

8. Risk management

There has been no material change in the policy or operation of the Treasury function over the quarter, the view is, therefore, that associated risks have remained consistently very low.

Cash balances have remained healthy as in the previous quarter; although there may be lower cash balances by the end of the year due to the profile of local taxation income, liquidity is not anticipated to create significant risk for the Council over the remainder of the year.

Aside from the above, there is also financial risk attached to the longer term debt portfolio, associated with interest rate exposure; there has been no change to this over the quarter. Although PWLB have increased their rates for new loans, this is not judged to impact on the risks linked to the current portfolio. To manage the risk attached to any new borrowing, market data will be used to ensure value for money is assured on any new debt.

As noted in section 4 above, there is uncertainty over some material elements of the capital programme. The financial risk that this creates is managed through regular reviews of expenditure to date as well as integration between capital budgeting and the treasury strategy, so that this can be factored into any decisions on whether to invest or borrow.

Finally, as per the previous quarterly updates, recovery of Icelandic investments is still being managed with legal support organised through the Local Government Association. Future views on recovery prospects will be informed by accounting guidance and information arising from the legal proceedings; hopefully there will be a clearer indication of the levels of recovery following the test cases on Landsbanki and Glitnir which are due to be heard during 2010/11 quarter 4.

A further element of risk management is the prudential framework; there have been no breaches of any prudential indicators in the quarter.

9. Conclusion

Consistent with the prior quarter, the third quarter of the 2010/11 has been steady in treasury management terms.

The appetite for risk has remained very low with the use of either AAA rated MMFs, instant access call accounts or deposits with HM Treasury. It is anticipated that this will remain low for the next annual strategy, which is currently under development.

Whilst some progress has been made in recovering Icelandic investments, the bulk of monies outstanding are still subject to court action with no new significant information as yet in terms of a likely outcome.

APPENDIX A1

INVESTMENT INTEREST EARNED TO 31 December 2010

Icelandic investments	No	Start	End	Rate %	Principal £	Cumulative Interest* £
Deposited 2007/08						
Landsbanki Islands	004	31-Mar-08	22-Apr-09	6.25	1,000,000	26,370
Glitnir	FI02/023	31-Mar-08	22-Apr-09	5.76	3,000,000	80,616
Deposited 2008/09						
Kaupthing, Singer & Friedlander	06/07-I29	16-May-08	07-Oct-08	6.00	1,282,500	30,137
Sub total					5,282,500.00	137,123

Other Investments	opening	Min	Max	closing	Indicative rate	Cumulative Interest £
Call: Abbey National	4,000,000	3,850,000	4,000,000	4,000,000	0.75%	10,322
Call: Yorkshire bank	2,000,000	2,000,000	2,000,000	2,000,000	0.50%	8,229
Call: RBS	2,000,000	2,000,000	2,000,000	2,000,000	0.70%	10,024
Call: Lancashire County Council	4,000,000	4,000,000	4,000,000	4,000,000	0.70%	12,647
DMADF	3,050,000	0	5,050,000	1,550,000	0.25%	8,435
Government Liquidity MMF	4,000,000	0	4,000,000	3,700,000	0.39%	9,378
Liquidity First MMF.	4,000,000	1,000,000	4,000,000	4,000,000	0.65%	15,113
Sub-total						74,148

TOTAL Interest		**211,271**

* Under the 2009 SORP, interest continues to be accrued whilst Icelandic investments are on the Council's balance sheet. As the full impairment on the investments was recognised in the 0910 accounts, it is anticipated that this interest will be credited to the General fund in 10/11. This may vary depending on subsequent guidance from CIPFA. £1,084K had been received from KSF as at the end of Qtr 3 2010/11 representing 53% of the total claim.

APPENDIX B

Treasury Management Strategy 2011/12 to 2013/14

Draft for Consideration by Cabinet 15 February 2011

Introduction

1. The treasury management function is an important part of the overall financial management of the Council's affairs. Its importance has increased as a result of the freedoms provided by the Prudential Code. Whilst the prudential indicators consider the affordability and impact of capital expenditure decisions, the treasury function covers the effective funding of these decisions. There are also specific treasury indicators included in this strategy that need approval.
2. The Council's activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management, revised November 2009: the "Code"). This Council originally adopted the Code on 13 February 2002, and adopted the revised Code from 2010/11 onwards.
3. The Code requires an annual strategy to be reported to Council outlining the expected treasury activity for the forthcoming 3 years. A further report is produced after the year-end to report on actual activity for the year. As a consequence of the revised Code, the a quarterly PRT report will also be referred to full Council by way of a mid year monitoring report.
4. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury function.
5. This strategy therefore covers:
    - the current treasury position;
    - expected movement in interest rates;
    - the Council's borrowing and debt strategy (including its policy on making provision for the repayment of debt);
    - the Council's Investment Strategy;
    - specific limits on treasury activities;
    - treasury management indicators; and
    - specific sections on training and the use of consultants.

    This strategy document contains the relevant information to comply with both the Code and the Investment Guidance issued by Government. The sections that specifically satisfy requirements of the Investment Guidance are: specified and non specified investments (31-39), credit risk assessment (32-44), use of investment consultants (50-51), training (52), borrowing in advance of need (22) and length of deposits (38-40).

Treasury Position

6. The forecast treasury position and the expected movement in debt and investment levels over the next three years are as follows.

Table 1: Gross external debt and investment forecast

	2011/12 Estimated	2012/13 Estimated	2013/14 Estimated
	£'000	£'000	£'000
EXTERNAL DEBT			
Borrowing	**39,200**	**39,200**	**39,200**
Other long term liabilities	**255**	**250**	**245**
Finance lease liability**	**4,500**	**4,500**	**4,500**
Total Debt at 31 March	**43,955**	**43,950**	**43,945**
INVESTMENTS			
Total investment adjusted for Iceland 31 March*	**11,570**	**9,360**	**9,200**
Projected average investment balances*	**15,960**	**15,570**	**14,590**

*Non Iceland investments plus cash due back as per CIPFA LAAP repayment schedules

**Estimate subject to IFRS adjustments to lease classifications

7. The current capital programme assumes an overpayment of £2.1M (during the 3 years 2011-12 to 2013-14) against capital expenditure to reverse prudential funding from prior years. This is reliant on a large capital receipt in 2011/12 relating to the sale of land at South Lancaster followed by further prudentially funded capital expenditure in 2012/13 and 2013/14. The investment profile remains fairly smooth because as cash is expended on capital, it is anticipated that there will be offsetting cash recovered from Icelandic investments. It is assumed that no new borrowings will be taken on and also that no loans will be physically repaid. The impact of a projected £1.1M of prudentially funded capital expenditure in 2010/11 has also been included in the figures in table 1.
8. The revenue consequences of these balances, namely investment income and borrowing costs (and the relevant recharges between the HRA), are included within the overall revenue budget. All these figures assume a 50/50 chance of preferential creditor status with Landsbanki and Glitnir, as is consistent with the charges put through the 2009/10 final accounts.
9. Although the Council holds both investment balances and long term borrowings, this is not a result of borrowing in advance of need or to on-lend. The Council's external borrowings provide the cash to help pay for a proportion of the Council's accumulated, prudentially funded, capital spend (the CFR). Separate to this, the Council is required to hold a certain amount of balances, provisions and other items to ensure that resources are available when needed; these are generally cash backed. Flexibility is allowed on utilising these cash funds in lieu of borrowing, which the Council is doing in part.
10. Further, the Council's closing cash position generally represents the lowest point throughout the year. The table above indicates that there is a core cash element of around £9M showing that there is capacity to net down the investment/borrowing position, saving the margin between the investment rates and the, currently far higher, borrowing costs. This is certainly a policy that the Council would consider should the conditions for early repayment without penalty occur.
11. As noted, the figures above include a projected liability for reclassification of operating leases to finance leases under the conversion to International Financial Reporting Standards. This is an accounting adjustment which the Council is required to do and which will lead to an increase in financing liabilities and the CFR. However, the figures are estimates only at this stage and are subject to sign off by external audit. Once this has been done, it may be that a separate report will be made to Members to explain the changes and amend any elements of the debt strategy and associated Prudential Indicators, if necessary.
12. One major factor that will have a significant impact on the treasury position is the proposed change to the HRA subsidy system under the Localism Bill. Indicative figures from DCLG suggest that the Council will have to make a payment to DCLG of £30M early in 2012-13

in exchange for not having to pay an annual amount through the subsidy system. However, the payments are still subject to finalisation by DCLG and the Localism Bill has yet to be brought into law. Due to the uncertainties over this, the strategy below does not make any further reference to the impact of HRA reforms. Although these should not impact on the strategy for 2011/12, figures for 2012/13 and 2013/14 could change materially. Further work will be required during 2011-12 in relation to the possible financing of this transaction, for inclusion in the strategy for 2012/13.

Scenario Review

13. The position above assumes that there will be no pressure to physically borrow to support the capital programme over the next three years and that the Council will be able to reverse £1.9M of previously incurred, prudentially funded, capital expenditure. There are however a number of further assumptions which this is based on. Table 2 below illustrates these and the potential impact they could have.

Table 2 Scenarios for the period 2011/12 to 2013/14

Scenarios	Cash impact	Capital impact	Annual Revenue impact	Comments
	£000	£000	£000	
Iceland best case	1,420	-1,420	90	£2.1M of Icelandic investment impairment was capitalised in 2009-10 and funded prudentially. Should a best case outcome occur, it is projected that most of this would be reversed (except the underlying KSF impairment) giving an ongoing MRP saving plus additional cash to invest with an anticipated return of £20K per annum. In addition, £1.4M of resources set aside to cover the worst case scenario would be a one off release back into the GF.
As presented	0	0	0	As presented.
Luneside additional costs	1,000	1,000	-60	There is potential additional expenditure required in relation to Luneside East; £1M is used for exemplification. It is anticipated that should this fall due, it would be taken out of investment balances with a knock on effect on investment income of approximately £10K with an ongoing MRP implication estimated at £50K per annum
South Lancaster	-7,240	7,240	-340	All of this funding is earmarked in the capital programme, if the receipt fell through, this would have an ongoing impact in terms of MRP estimated at between £200K and £300K per annum, this would also mean that the demands of the capital programme would wipe out cash balances for investments, estimated at £90K per annum.

*investment losses based on average Bank rate over the period of 1.2%.

14. From the table above it is clear that the capital receipt from the sale of land at South Lancaster remains a key assumption underpinning the TM strategy. It could have a large impact on the Council's borrowing requirement and its treasury position, be this increased loans or depleted cash (as assumed above). There would also be an ongoing MRP consequence relating to the capital expenditure which would no longer be fundable through capital receipts.

15. The impact of Iceland has reduced relative to last year's figures but this is mostly due to the Council having already capitalised £2.1M of the impairment whilst setting aside a further £1.4M to cover the difference between the assumption of a 50/50 chance of

preferential creditor status and the worst case scenario. The degree of uncertainty on Luneside has reduced from prior years given the successful result on the valuation basis but there is still material uncertainty over the costs to settle the unresolved land acquisitions on the site. The Council was successful in defending its valuation basis so although there is still uncertainty over the net outcome of the various land acquisitions and legal fees, the degree of uncertainty is now thought to be within a smaller financial limit.

Expected Movement in Interest Rates

Table 3: Medium-Term Rate Estimates (averages)

Annual Average %	Bank Rate	Money Rates		PWLB Rates*			
		3 month	1 year	5 year	10 year	25 year	50 year
2010/11	0.5	0.7	1.5	2.6	3.7	4.6	4.7
2011/12	0.7	0.9	1.8	3.5	4.5	5.3	5.3
2012/13	1.7	1.9	2.8	4.0	5.0	5.4	5.4
2013/14	3.1	3.3	3.8	4.8	5.3	5.6	5.6

* Borrowing Rates

Information provided by Butlers Consultants January 2010.

16. The key theme of uncertainty continues with mixed economic data undermining robust medium term projections. Whilst short-term rates are expected to remain on hold through most of 2011, inflation has been above the 2% target for so long that this will make the Bank of England's Monetary Policy Committee (MPC) decisions during 2011 difficult to project as an equally important pressure is whether rates need to be kept low to aid the recovery, particularly given the recently reported 0.5% shrinkage in GDP for 2010 quarter 4.
17. The Government's determination to cut the size of the public sector deficit will be a drag upon activity in the medium term. The void left by significant cuts in public spending will need to be filled by a number of alternatives. These are corporate investment, rising exports (assisted by the fall in the value of sterling) and consumers' expenditure. In terms of sheer magnitude, the latter is the most important and strong growth in this area is by no means certain. The combination of the desire to reduce the level of personal debt, lack of access to credit and continued job uncertainty is likely to weigh heavily upon spending. This will be amplified by the fiscal policy tightening, in the Comprehensive Spending Review. Without growth in personal spending remaining robust, any recovery in the economy is set to be weak and protracted.
18. Fiscal support in the US through the extension of tax cuts and monetary support through the extension of quantitative easing (QEII, with the potential for further easing), has had an adverse effect on world bond markets. Following the recent sell off the outlook for long term interest rates is favourable in the near term, but is set to deteriorate again in the latter part of 2011. The increase in yields will be suppressed by continued investor demand for safe haven instruments following the uncertainties and unfolding tensions within the entire Eurozone. In addition to this, the market has been underpinned by evidence of moderating activity in major economies and the coalition government's determination to deal with the parlous state of public sector finances. These two factors will restrict any deterioration in gilt market performance in the near term.
19. However, while the UK's fiscal burden will almost certainly ease, it will be a lengthy process and deficits over the next two to three financial years will still require a very heavy programme of gilt issuance. The latest Bank Inflation Report suggests the market will not

be able to rely upon Quantitative Easing indefinitely to alleviate this enormous burden. Eventually, the absence of the Bank of England as a continued buyer of gilts will shift the balance between supply and demand in the gilt-edged market. Other investors will almost certainly require some incentive to continue buying government paper. This incentive will take the form of higher yields. The longer dated maturities will suffer from the lack of support from the major savings institutions (pension funds and insurance companies) who will continue to favour other investment instruments as a source of value and performance. Although the FSA has recently delayed implementation of their liquidity requirements, the regulator will still look to ensure banks have necessary short term liquidity. The front end of the curve will benefit from this and will ensure the steeply-positive incline of the yield curve remains intact. The consequence of this will be that the spread between long and short term PWLB rates is likely to continue although rates in general are likely to rise across the board.

Borrowing and Debt Strategy 2011/12 to 2013/14

20. The continued uncertainty over future interest rates increases the risks associated with treasury activity. As a result there is no strong argument for a significant relaxation of the Council's treasury strategy. As outlined in the scenarios section above, there are also a number of other factors outside of the Council's direct control, which could have a significant impact on its need to borrow. As these issues are clarified, the options around borrowing will be considered in relation to the longer term prospects of rate rises.
21. The Head of Financial Services, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, if need be, taking into account the risks shown in the forecast above. It is likely that shorter term fixed rates may provide lower cost opportunities in the short to medium term.
22. Borrowing will only be taken on once a liability has been established although the timing of the borrowing may precede the point at which the liability actually falls due for payment. This would only be done to secure a preferential position for the Council, for example to benefit from lower interest rates.
23. With the likelihood of rates increasing, any debt restructuring is likely to focus on switching from longer term fixed rates to cheaper shorter term debt, although the Head of Financial Services and treasury consultants will monitor prevailing rates for any opportunities during the year. The benefit of this will be balanced against the risks attached to the more frequent refinancing that would be required.
24. The option of postponing borrowing and running down investment balances will also be considered, this would have the added benefit of further reducing counterparty risk and also could improve the revenue situation with the cost of loans currently far outweighing the return on investments, as already mentioned in paragraph 10 above.

Provision for the Repayment of Debt 2011/12 to 2013/14

25. Up until 2007/08 the Council calculated the basic amount of provision, which it sets aside each year from revenue for the repayment of debt, in accordance with a prescribed formula based on the CFR. To this was added a further provision in respect of the financing of assets with relatively short lives, as considered prudent.
26. The new arrangements were introduced from 1 April 2008. In summary:
    - the prescribed formula has been abolished and replaced by a simple requirement for Councils to make 'prudent' provision;
    - the old calculation may still be used for relevant capital expenditure before 31 March 2008, but
    - provision relating to relevant capital expenditure after this date must either be based on the estimated life of the asset, or equal to the depreciation on the asset.

27. The new arrangements also included reference to 'supported' or unsupported' capital expenditure:

    - 'Supported' is the amount of capital expenditure for which the authority has received revenue support from Government to help meet the financing costs. (i.e. for credit / borrowing – it excludes grant financing).
    - 'Unsupported' is where the authority receives no such revenue assistance (often also referred to as prudential borrowing).

28. Financially, the new arrangements for calculating the Minimum Revenue Provision (MRP) have no real impact on the Council because the changes effectively codify the full 'prudent' provision which the Council was already making. Nonetheless, as an element of discretion has been introduced the Council's approach must be formalised within the borrowing strategy.

29. Therefore, for 2011/12, the Council's policy for the making of provision for the repayment of debt will be as follows:

    - For all relevant capital expenditure prior to 1 April 2008, with the exception of that in respect of motor vehicles (i.e. less than 15 years life), by the application of the former prescribed formula *(i.e. for General Fund, 4% of the non-housing related Capital Financing Requirement at the start of the year)*.
    - For capital expenditure on motor vehicles prior to 01 April 2008, and for all supported or unsupported capital expenditure on or after that date, equal annual amounts based on the estimated life of each individual asset so financed, as is consistent with the revised Minimum Revenue Provision guidance (February 2008, method 3).
    - For finance leases the annuity method will be used to ensure the total charges in year remain constant (MRP plus interest cost) and match what would otherwise be an annual revenue cost. This is also to be applied retrospectively to any operating leases re-classified as finance leases under the transfer to IFRS for the 2010-11 final accounts.

Investment Strategy 2011/12 to 2013/14

30. The primary objective of the Council's investment strategy is to safeguard the re-payment of the principal and interest of its investments, with ensuring adequate liquidity being the second objective, and achieving investment returns being the third.

31. The types of investment allowable are categorised as either Specified and Non Specified investments. Details of these are set out in ***Appendix B1***.

32. Following the economic background described above, the current investment climate has one over-riding risk consideration, that of counterparty security risk. The Head of Financial Services will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. The use of these criteria provides an overall pool of counterparties that are considered as high quality and that may be chosen for investment, subject to other considerations.

33. The rating criteria use the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside of the lending criteria. This complies with a CIPFA Treasury Management Panel recommendation in March 2009 and the Code.

34. Credit rating information is supplied by the Council's treasury consultants (Sector) on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible

longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. More information on credit ratings is included in ***Appendix B2***.

35. The criteria for providing a pool of high credit quality investment counterparties (for both specified and non-specified investments) are:

- **Banks 1 - Good Credit Quality**

  The Council will only use banks that:

  a) are UK banks; or
  b) are non-UK but are domiciled in an EU country with a long term sovereignty rating of AAA,

  and have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated, as is consistent with the middle limit as per table 4):

  i. **Short Term:** F1/P-1/A-1

  ii. **Long Term:** A/A2/A

  iii. **Individual / Financial Strength:** C (Fitch / Moody's only)

  iv. **Support:** 3 (Fitch only)

- **Banks 2 – Guaranteed Banks with suitable Sovereign Support**

  In addition, the Council will use EU banks whose ratings fall below the criteria specified above if all of the following conditions are met:

  a) wholesale deposits in the bank are covered by a government guarantee;

  b) the government providing the guarantee is rated "AAA" by all three major rating agencies (Fitch, Moody's and Standard & Poors); and

  c) the Council's investments with the bank are limited to amounts and maturities within the terms of the stipulated guarantee.

- **Banks 3 – Eligible Institutions**

  The Council will use banks where the organisation was an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008, with the necessary short and long term ratings required in *Banks 1* above. These institutions have been subject to suitability checks before inclusion, and have access to HM Treasury liquidity if needed. These will continue to be included on the counterparty list even if the credit guarantee scheme is withdrawn although the Head of Financial services may restrict their usage.

- **Banks 4 – The Council's own Banker**

  The bank may be used for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.

- **Building Societies –** all Societies that meet the ratings for banks outlined above.

- **Money Market Funds –** AAA-rated sterling funds with constant unit value.

- **UK Government –** Debt Management Account Deposit Facility (DMADF)

- **Local Authorities (including Police and Fire Authorities), Parish Councils**

- **Supranational institutions** (e.g. European Central Bank)

36. Due care will be taken to consider the country, group and sector exposure of the Council's investments. In part the country selection will be chosen by the credit rating of the Sovereign state in *Banks 1* above. In addition:

- no more than 25% will be placed with any one non-UK country at any time;
- limits in place above will apply to Group companies;
- Sector limits will be monitored.

37. The Code and Investment Guidance now require the Council to supplement credit rating information. Whilst the Council's strategy relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (e.g. credit default swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

38. For the above categories of Specified and Non Specified Investments, and in accordance with the Code, the Council has developed additional criteria to set the maximum amounts that may be invested in these bodies. The criteria, using the lowest common denominator approach are set out below.

Table 4: Counterparty Criteria and Investment Limits

	Minimum across all three ratings			Money Limit[7]	Time Limiit[8]
	Fitch	Moody's	Standard & Poors		
Upper Limit[1]	F1+/AA-	P-1/AA3	A-1+/AA-	£6M	Instant access only
				£3M	3 months
				£2M	1 Year
Middle Limit[2]	F1/A	P-1/A2	A-1/A	£3M	Instant access only
Other Institutions[3]	N/A	N/A	N/A	£6M	1 Year
Money Market Funds[4]	AAA	AAA	AAA	£6M	Instant Access Only
DMADF deposit[5]	N/A	N/A	N/A	£20M	1 Year
Sovereign rating to apply to all non UK counterparties[6]	AAA	AAA	AAA	N/A	N/A

Notes:

1 & 2: The Upper and Middle Limits apply to appropriately rated banks and building societies.
3: The Other Institutions limit applies to other local authorities and supranational institutions (i.e. ECB).
4: Sterling, constant net asset value funds only.
5: The DMADF facility is direct with the UK government, it is extremely low risk and hence the higher limit.
6: UK investments are defined as those listed under UK banks or building societies in the Butler's counterparty listing.
7: Money limits apply to principal invested and do not include accrued interest.
8: Time Limits start on the trade date for the investment.

39. In the normal course of the Authority's cash flow operations it is expected that both specified and non-specified Investments will be utilised for the control of liquidity as both categories allow for short term investments. The Council will maintain a minimum £2M of investments in Specified Investments provided that the cashflow allows for this. In addition, although the Council will consider using non specified investments (as described in append B1), these should not exceed 50% of the portfolio at any one time. The limits applied will be consistent with the short and long term ratings in table 4 above.

40. The use of longer term instruments (greater than one year from trade date to maturity) and forward deals will not be used.

41. Expectations on shorter-term interest rates, on which investment decisions are based, show a likelihood of the current 0.5% Bank Rate increasing moderately over the next 12 months but with the possibility of a steeper rise in 2012-13. The Council's investment decisions are based on comparisons between the rises priced into market rates against the Council's and advisers own forecasts.

42. There is some operational difficulty arising from the legacy of the banking crisis, although there is some value returning to longer term investment, credit risk remains within the market. Whilst some selective options do provide additional yield, uncertainty over counterparty creditworthiness indicates that shorter dated investments still provide better security. However, for institutions in the upper limit category, limited amounts of fixed term investing are judged to be acceptable.

43. Members are asked to approve the base criteria above, however, the Head of Financial Services may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval.

44. Examples of these restrictions include greater use of the Debt Management Deposit Account Facility (DMADF – a Government body which accepts local authority deposits), guaranteed deposit facilities and strongly rated institutions offered support by the UK Government as appropriate. The credit criteria reflect these facilities.

Risk benchmarking

45. A further development in terms of managing risk is the use of security and liquidity benchmarks, above and beyond the limits on time and creditworthiness listed above. Yield benchmarks are currently widely used to assess investment performance but more sophisticated security and liquidity benchmarks could be set by Members and incorporated into reporting. The purposes of the benchmarks would be to further aid Officer monitoring of the current and trend positions and to inform any amendments to the operational strategy.

46. At present, the criteria set down in table 4 above and through the treasury management indicators below, limit activity in terms of length of deposit (liquidity and security) and in terms of strength of the counterparty (security). The current strategy follows on from the 2010/11 strategy in being low risk through, for example, restricting the amount and length of deposit in any one counterparty as well as mandating high liquidity on larger deposits. The use of benchmarking would allow the Council to set more subtle strategic parameters on investments that allow for an 'acceptable' level of risk in the portfolio. For example, Members could set a benchmark for 'average days to maturity' to supplement the time limits already given in table 4 above. This is something that will be considered and developed during the year.

Treasury Management Indicators and Limits on Activity

47. There are four mandatory treasury management Indicators. The purpose of these 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. The full list of Prudential Indicators is included elsewhere on the agenda, but the treasury management indicators are as follows:

    - Upper limits on fixed interest rate exposure – This indicator identifies a maximum limit for fixed interest rates based upon the debt position net of investments.
    - Upper limits on variable interest rate exposure – Similar to the previous indicator, this covers a maximum limit on variable interest rates.
    - Maturity structures of borrowing – These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

- Total principal funds invested for greater than 364 days – given the current economic climate the Authority is not willing to risk investing sums for fixed terms of greater than 1 year and so this is £0.

48. Council will also be requested to approve the treasury management indicators, as updated in line with final budget proposals, at its meeting on 02 March 2011.

Table 5: Treasury Management Indicators

	2011/12		2012/13		2013/14	
Interest Rate Exposures (TM 1 & 2)						
	Upper		**Upper**		**Upper**	
Limits on exposure to fixed interest rates	100%		100%		100%	
Limits on exposure to variable interest rates	30%		30%		30%	
Maturity Structure of fixed interest rate borrowing (TM 3)						
	Lower	**Upper**	**Lower**	**Upper**	**Lower**	**Upper**
Under 12 months	0%	35%	0%	35%	0%	35%
12 months to 2 years	0%	20%	0%	20%	0%	20%
2 years to 5 years	0%	20%	0%	20%	0%	20%
5 years to 10 years	0%	20%	0%	20%	0%	20%
10 years to 15 years	0%	100%	0%	100%	0%	100%
15 years to 25 years	0%	100%	0%	100%	0%	100%
25 years to 50 years	50%	100%	50%	100%	50%	100%
Actual current position						
Under 12 months	0%		0%		0%	
12 months to 2 years	0%		0%		0%	
2 years to 5 years	0%		0%		0%	
5 years to 10 years	0%		0%		0%	
10 years to 15 years	0%		0%		0%	
15 years to 25 years	0%		0%		0%	
25 years to 50 years	100%		100%		100%	
Maximum principal sums invested > 364 days (TM 4)						
Principal sums invested, in 2011/12, for periods of greater than 364 days, to mature after the end of each financial year	£0M		£0M		£0M	

Performance Indicators

49. The Code 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 that are predominantly forward looking. Examples of performance indicators often used for the treasury function are:

- Debt – Average rate movement year on year
- Investments – Internal returns above the 7 day LIBID rate

The results of these indicators will be reported in the Treasury Annual Report and the mid-year report as required under the Code.

Treasury Management Advisers

50. The Council currently uses Sector as its treasury management consultants. The company provides a range of services that include:
    - technical support on treasury matters, capital finance issues and the drafting of Member reports;
    - economic and interest rate analysis;
    - debt services which includes advice on the timing of borrowing;
    - debt rescheduling advice surrounding the existing portfolio;
    - generic investment advice on interest rates, timing and investment instruments;
    - credit ratings/market information service comprising the three main credit rating agencies;
51. Whilst the advisers provide support to the internal treasury function, under current market rules and the Code the final decision on treasury matters remains with the Council. The service is subject to regular review.

Member and Officer Training

52. The increased Member consideration of treasury management matters and the need to ensure Officers dealing with treasury management are trained and kept up to date requires a suitable training process for Members and officers. This Council addresses this important issue by providing Member training in liaison with its treasury advisors and through ongoing training and supervision of officers involved the day to day operation of the treasury function.

APPENDIX B1

Definitions of Specified and Non Specified Investments

See the detailed Investment Strategy included in Appendix B, for the limits to be applied.

1. Specified Investments are defined as follows.

SPECIFIED INVESTMENTS

These are to be sterling investments of a maturity period of not more than 364 days, or those which could be for a longer period but where the Council has the right to be repaid within 364 days if it wishes. These are low risk assets where the possibility of loss of principal or investment income is considered negligible. These include investments with:

(i) The UK Government (such as the Debt Management Office, UK Treasury Bills or a Gilt with less than one year to maturity).

(ii Supranational bonds of less than one year's duration.

(iii) A local authority, parish council or community council.

(iv) An investment scheme that has been awarded a high credit rating by a credit rating agency.

(v) A body with high credit quality (such as a bank or building society).

For category (iv) this covers a money market fund AAA rated by Standard and Poor's, Moody's or Fitch rating agencies.

2. Non-specified Investments are defined as follows:

Non-specified investments are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments are set out below. Non specified investments not explicitly referred to below are excluded.

Ref	Non Specified Investment Category	Limit
(i)	A body which has been provided with a government issued guarantee for wholesale deposits within specific timeframes. Where these guarantees are in place and the government has an AAA sovereign long term rating these institutions will be included within the Council's criteria temporarily until such time as the ratings improve or the guarantees are withdrawn. Monies will only be deposited within the timeframe of the guarantee.	Included as per Appendix B
(ii)	A body which was an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008.	Included as per Appendix B
(iii)	The Council's own banker if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.	Included as per Appendix B

APPENDIX B2

Background information on credit ratings

Credit ratings are an important part of the Authority's investment strategy. The information below summarises some of the key features of credit ratings and why they are important.

What is a Credit Rating ?

A credit rating is:

- An independent assessment of an organisation;
- It gauges the likelihood of getting money back on the terms it was invested;
- It is a statement of opinion, not statement of fact;
- They help to measure the risk associated with investing with a counterparty;

Who Provides / Uses Credit Ratings?

There are three main ratings agencies, all of which are used in the Authority's treasury strategy.

- Fitch
- Moody's Investor Services
- Standard & Poors

The ratings supplied by these agencies are used by a broad range of institutions to help with investment decisions, these include:

- Local Authorities;
- Other non-financial institutional investors;
- Financial institutions;
- Regulators;
- Central Banks;

Rating Criteria

There are many different types of rating supplied by the agencies. The key ones used by the Authority are ratings to indicate the likelihood of getting money back on terms invested. These can be split into two main categories:

- 'Short Term' ratings for time horizons of 12 months or less. These may be considered as the most important for local authorities.

- 'Long Term' ratings for time horizons of over 12 months. These may be considered as less important in the current climate.

In addition, the agencies issue sovereign, individual and support ratings which will also feed into the investment strategy.

Rating Scales (Fitch, Moody's and Standard & Poors)

The table below shows how some of the higher graded short and long term ratings compare across the agencies; the top line represents the highest grade possible. (There are other ratings that go much lower than those shown below, and ratings for other elements.)

Short Term			**Long Term**		
Fitch	Moody's	S&P	Fitch	Moody's	S&P
F1+	P-1	A-1+	AAA	Aaa	AAA
F1	P-1	A-1	AA	Aa2	AA
F2	P-2	A-2	A	A2	A

APPENDIX C

TREASURY MANAGEMENT FRAMEWORK DOCUMENTS AND RESPONSIBILITIES

For Consideration by Cabinet 15 February 2011

DOCUMENT	RESPONSIBILITY
CODE of PRACTICE	To be adopted by Council (as updated November 2009).
POLICY STATEMENT	The Code of Practice recommends a specific form of words to be used, to set out the Council's objectives within the Policy Statement for its Treasury Management activities. It is the responsibility of Council to approve this document, and then note it each year thereafter if unchanged. This reflects the revised code November 2009.
TREASURY MANAGEMENT STRATEGY	The Strategy document breaks down the Policy Statement into detailed activities and sets out the objectives and expected market forecasts for the coming year. This also contains all the elements of an Investment Strategy as set out in the DCLG guidance; it is the responsibility of Council to approve this document, following referral from Cabinet.
TREASURY MANAGEMENT INDICATORS	These are included within the Strategy Statement as part of the framework within which treasury activities will be undertaken. It is the responsibility of Council to approve these limits.
INVESTMENT STRATEGY	The Investment Strategy is included within the Treasury Management Strategy. It states which types of investments the Council may use for the prudent management of its treasury balances during the financial year. Under existing guidance the Secretary of State recommends that the Strategy should be approved by Council.
TREASURY MANAGEMENT PRACTICES	These are documents that set out the procedures that are in place for the Treasury Management function within the Council. The main principles were approved by Cabinet following initial adoption of the Code of Practice; they include: *TMP 1:* Risk management *TMP 2:* Performance measurement *TMP 3:* Decision-making and analysis *TMP 4:* Approved instruments, methods & techniques *TMP 5:* Organisation, clarity and segregation of responsibilities, and dealing arrangememts. *TMP 6:* Reporting requirements & management information requirements *TMP 7:* Budgeting, accounting & audit *TMP 8:* Cash & cash flow management *TMP 9:* Money laundering *TMP 10:* Staff training & qualifications *TMP 11:* Use of external service providers *TMP 12:* Corporate governance Any changes to the above principles will require Cabinet approval. It is the Head of Financial Service's responsibility to maintain detailed working documents and to ensure their compliance with the main principles. It is highlighted that for 2011/12, quarterly treasury management reports will continue to be included within Corporate Financial Monitoring and reported through to Members.

BUDGET AND PERFORMANCE PANEL

Work Programme Report
22 February 2011

Report of Head of Governance

PURPOSE OF REPORT
To update Members regarding the Panel's Work Programme.
This report is public

RECOMMENDATIONS

(1) That Members note the items to be carried forward for consideration at future meetings, as detailed in Appendix A to the report.

(2) That Members consider whether they would like to include any further items in the work programme.

1.0 Introduction

This report provides Members with recommendations for inclusion in the Panel's Work Programme and advises regarding upcoming items for consideration and work in progress.

2.0 Report

2.1 Upcoming Items

- Report from the Children and Young People Thematic Group on the work undertaken by the Thematic Group in 2009/10 regarding delivering the targets in the sustainable communities strategy. The Thematic Group is also district Children's Trust, which has been undergoing a forced structural change. The new structure has now been agreed and a Chair has been appointed. The report will be presented to the Panel by the Local Strategic Partnership Manager at its meeting on 29 March 2011.

Details of upcoming items are detailed in Appendix A to the report.

BACKGROUND PAPERS	**Contact Officer: Tom Silvani** **Telephone:** 01524 582132 **E-mail:** tsilvani@lancaster.gov.uk **Ref:** ts

BUDGET AND PERFORMANCE PANEL
WORK PROGRAMME

Matters for Consideration	Officer Responsible	Meeting date
Updates on the work of the Affordable Housing Task Group, once established.	Head of Regeneration and Policy	TBC
Report on the Children and Young People Thematic Group, once the chairmanship of the Group and matters concerning the Children's Trusts are determined.	Head of Community Engagement	29 March 2011
Report from the Chair of the Children and Young People Thematic Group to Budget and Performance Panel on the work undertaken by the Thematic Group in 2009/10 in respect of delivering the targets in the Sustainable Community Strategy.	Head of Community Engagement	29 March 2011