SOUTHEND-ON-SEA BOROUGH COUNCIL

TREASURY MANAGEMENT STRATEGY 2011/12

1. Introduction

1.1 The Treasury Management Strategy is written in compliance with the CIPFA Treasury Management Code of Practice requirement to review and report policy and strategy before the start of the year. This has been revised following publication of the revised Code of Practice.

1.2 The Treasury Management Strategy sets out how the financing costs, a large but mostly unrecognised part of the Council's budget plan, may be achieved. It needs to be regularly monitored and modified in the light of changing external and internal circumstances.

1.3 The objective of the strategy is to optimise the income generated by surplus cash and minimise borrowing costs, consistent with a low level of risk, maintaining capital sums and maintaining liquidity.

2. The Council's Budget

2.1 The budget includes provision for the financing costs of the Council's Capital Programme, including interest on external borrowings. Offsetting this, the Council will earn interest by temporarily investing its surplus cash, which includes unapplied and set-aside capital receipts. These budgets depend on many factors, not least the Council's level of revenue and capital budgets, use of reserves, methods of funding the budget requirement, interest rates, cash flow and the Council's view of risk.

2.2 The Council can be both a lender and borrower at the same time as it seeks to invest short-term surpluses and fund longer-term capital investment. The timing of the taking of borrowing is important to secure the most advantageous interest rates.

2.3 The net budget for financing costs, less interest earned on balances, is £10.9m in 2011/12.

3. The Council's Cash Surplus and Cash Flow

3.1 It is projected that surplus cash balances will average £89m (of which £48m is managed by two fund managers) during 2011/12 based on information currently available and historical spending patterns. Average cash balances may fall in future years as existing cash is used in lieu of new borrowings to finance the capital programme, now that borrowing rates from the PWLB have increased.

4. Interest Earnings

4.1 At the date of this report, the Bank of England base rate was 0.50%. Based on economic forecasts, it is assumed that the bank base rate will rise during 2011/12 to 0.75% and possibly 1%. The average interest earned by the Council on its lending is likely to be 1.21% assuming the council can take advantage of advantageous changes in the level or structure of interest rates.

4.2 Sensitivity analysis shows that a difference of 0.5% in interest rates would make a difference of £447k in external interest earned and a difference of £1m in average balances would make a difference of £12k in interest earned in a full year. This risk has been reflected in the review of the robustness of estimates undertaken by the Head of Finance and Resources.

5. Long Term Borrowing

5.1 As part of the finance settlement Central Government have announced that there will be no funding in 2011/12 to support borrowing by the Council to fund capital projects. Under the Prudential Code the cost of any additional borrowing would have to be financed by the Council.

5.2 The funding available to support capital investment is based on an assumption that the Council will undertake prudential (unsupported) borrowing in 2011/12 of £21m. The revenue impact of this borrowing is funded in the Revenue Budget proposals. As an indicative guide to this revenue impact, there is a cost of approximately £80k for every £1m borrowed.

5.3 The Capital Financing Requirement (CFR) is the council's theoretical need to borrow but the Section 151 Officer can manage the council's actual borrowing position by either:

1 - borrowing to the CFR;
2 - choosing to use temporary cash flow funds instead of borrowing (internal borrowing) or;
3 - borrowing for future increases in the CFR (borrowing in advance of need)

The Council is likely to begin 2011/12 in the first of the above scenarios.

5.4 This authority will only borrow in advance of need where there is a clear justification for doing so and will only do so for the current capital programme or to finance future debt maturities.

5.5 The financing of the capital programme requires the generation of substantial capital receipts from the sale of existing surplus Council assets. Due to the economic conditions it is not anticipated that this level of capital receipts will be generated in the timescale required.

Some of the borrowing has therefore been over a short period to bridge the gap and it is anticipated that capital receipts will be received to repay this borrowing.

5.6 So far in 2010/11 £40m of new loans have been taken out for a period of between one and five years and a loan of £10m was taken out to re-finance a loan initially taken out in 2009/10 for a period of one year.

5.7 The Council's current outstanding loans (estimated as at 31st March 2011) which must be repaid:

- Southend-on-Sea Borough Council £201.3m
- ECC transferred debt £ 17.2m

5.8 New loans in 2011/2012 are estimated at:

- Southend-on-Sea Borough Council £31.0m
- ECC transferred debt £ 0.0m

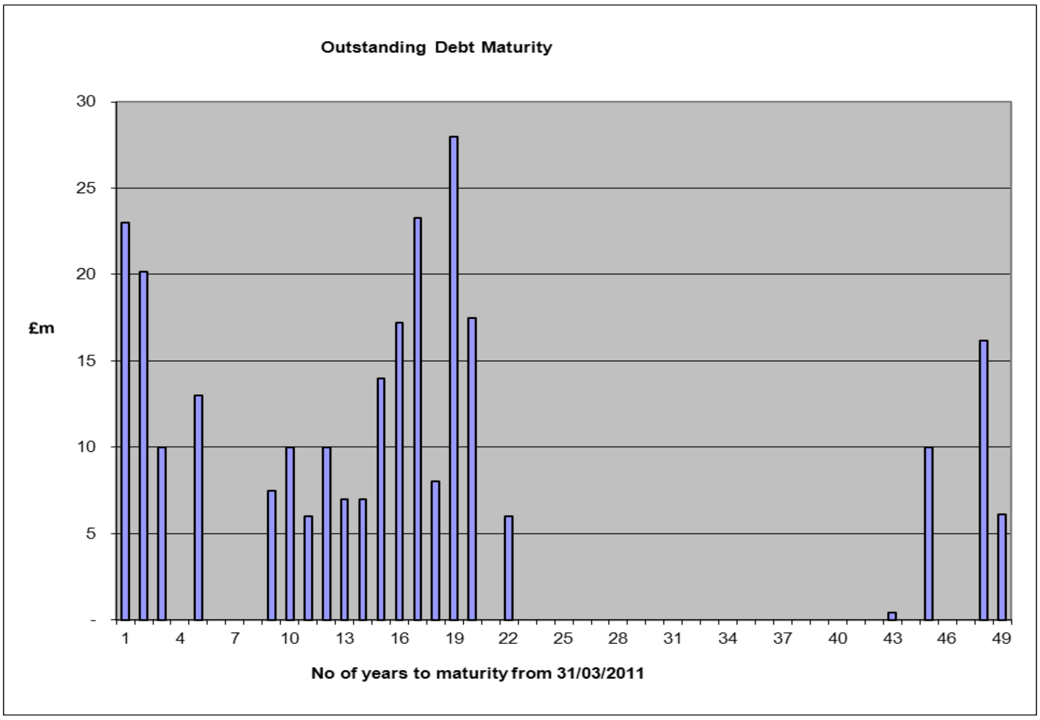
£10m of these new loans are to refinance existing loans due to mature.

5.9 Repayments in 2011/2012 are estimated at:

- Southend-on-Sea Borough Council £23.2m
- ECC transferred debt £ 0.7m

5.10 Outstanding debt relating to services transferred from Essex County Council (ECC) on 1st April 1998, remains under the management of ECC. Southend Borough Council reimburses the debt costs incurred by the County.

5.11 The graph overleaf shows the repayment profile of the Council's borrowings if all new loans are included to reflect the funding of the proposed capital programme and the refinancing of debt.



It shows that more than 85% of the loans are repayable within 22 years from 31st March 2011, and a gap in the repayment profile between 23 and 43 years.

5.12 The potential for the early redemption of high interest loans is reviewed periodically, however the interest savings from the repayment of these loans is usually offset by the premiums that must be paid on their redemption and it has not yet been advantageous for the Council to discharge these loans prematurely. However the advice of our treasury management advisers will be sought about the potential for restructuring of debt and the timing of such a restructure.

5.13 Long term borrowing will normally be taken from the Public Works Loan Board (PWLB) since this is usually the most economic source available to the Council. If other sources are thought to be more advantageous and are permitted under the relevant legislation they will be considered.

5.14 As at 22nd December 2010 rates of borrowing (from the PWLB) were between 1.71% and 4.61% for loans 10 years or less. During 2011/12 the investment and borrowing interest rates will be kept under review and the further use of capital balances will be considered in lieu of new borrowing where this is advantageous.

5.15 Where it is considered appropriate to take out new borrowing, regard will be given to the existing repayment profile (see 5.11 above) and the need for a spread of maturity dates to ensure that a significant value of loans do not mature at the same time. Loans are taken out for a range of periods in order that the Council continues to balance its debt profile over the longer term and so is not unduly exposed to the prevailing interest rates at the time of the possible debt replacement.

6. Monitoring and Review Arrangements

6.1 During 2011/12, within 7 working days of each month end, the Section 151 Officer will receive a report detailing performance and any non-compliance with the treasury management policy. They will either approve the report or raise the necessary queries to satisfy themselves in relation to:

(i) all transactions being properly authorised
(ii) all transactions being with approved counterparties
(iii) all transactions being in accordance with the Council's approved policy
(iv) monitoring of security and liquidity (i.e. spread of investments by long term credit rating, financial sector, country, maturity profile)
(v) in-house investment performance against 7 day LIBID
(vi) investment performance against benchmark for external fund managers for the previous month

6.2 In addition to the monthly reports:

(i) monitoring reports will be included in the regular Performance Monitoring report
(ii) any changes affecting the treasury management strategy will be reported to Audit Committee for scrutiny then to Cabinet for recommending to Council for approval.

6.3 Benchmarking that considers security and liquidity will be achieved by appropriate comparisons with relevant statistical data.