

<b>WYFRA</b>	<b>FINANCE &amp; BEST VALUE COMMITTEE</b>	<b>3 FEBRUARY 2006</b>	<b>ITEM No</b>
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**REPORT OF:** CHIEF EXECUTIVE/CHIEF FIRE OFFICER, THE DIRECTOR OF CORPORATE RESOURCES AND THE CHIEF FINANCE OFFICER

**PURPOSE OF REPORT:** THE PURPOSE OF THIS REPORT IS TO PRESENT A DRAFT CAPITAL INVESTMENT PLAN, A DRAFT REVENUE BUDGET AND A TREASURY MANAGEMENT STRATEGY FOR THE THREE YEARS 2006/2007 TO 2008/2009

**RECOMMENDATION:** IT IS RECOMMENDED THAT THE REPORT IS NOTED AS THE BASIS FOR THE POLITICAL GROUPS TO CONSIDER THEIR BUDGET PROPOSALS.

**LOCAL GOVERNMENT (ACCESS TO INFORMATION) ACT DETAILS**

**EXEMPTION CATEGORY:** NONE

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**BACKGROUND TO PAPERS OPEN TO INSPECTION:** BUDGET WORKING PAPERS LOCAL GOVERNMENT FINANCE SETTLEMENT.

## 1. INTRODUCTION

This is a consolidated report which will present the Management Board's proposals for:-

- (i) a Capital Investment Plan for the three years 2006/2007 TO 2008/2009;
- (ii) to present the prudential indicators to support the financing of the capital plan.
- (iii) a Revenue Budget for the same period; and
- (iv) a Treasury Management Strategy to fund the Capital Investment Plan and the cash flow implications of the 3 year Revenue Budget.

The consolidation is intended to show how all three elements are very closely related.

## 2 PROPOSED CAPITAL INVESTMENT

- 2.1 The Management Board is proposing a level of new investment over the period 2006/07 to 2008/09 amounting to **£23.6m**. The detailed plans are attached at Appendix A with the summary at programme level as follows:-

### Overall Summary of Capital Investment Plan

	2006/07	2007/08	2008/09
	£m	£m	£m
Corporate services	6.309	5.619	4.319
Fire Safety and community relations	0.538	2.500	0.200
Human resources	2.574	0.225	0.300
Operations	0.372	0.325	0.325
	_____	_____	_____
Planned Investment	9.793	8.669	5.144
	_____	_____	_____

- 2.2 The costs of funding the proposed capital programme have been included within the draft revenue budget.
- 2.3 It is proposed that the investment is funded by borrowing. The overall summary of the funding is shown on the first page of Appendix 1 and indicates that the level of new borrowing will be £23.6m over the next three years.

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### 3 **WYFRA – PRUDENTIAL INDICATORS**

3.1 This budgetary cycle provides for the third full year of the operation of the CIPFA Prudential Code. The Code requires that local authorities produce a number of prudential indicators before the beginning of each financial year and have them approved by the same executive body that approves the budget. The purpose of the indicators is to provide a framework for capital expenditure decision making, highlighting the level of capital expenditure, the impact on borrowing levels, and the overall controls in place to ensure the activity remains affordable, prudent and sustainable.

Some of the indicators are specific to the Authority's treasury management activity and are set out in the treasury management section of this report. The rest of the indicators are set out below.

#### 3.2 **Capital Expenditure, Capital Financing Requirement and External Debt**

The Authority's capital expenditure projections, detailed elsewhere in this report, are summarised below. Capital expenditure impacts directly on the Capital Financing Requirement (CFR) and the Authority's debt position. The CFR reflects the Authority's underlying need to borrow for a capital purpose. The difference between the CFR and external borrowing reveals that the Authority is using some internal balances, such as reserves/creditors, to temporarily finance capital expenditure.

	Actual 2004/05 £000s	Estimate 2005/06 £000s	Estimate 2006/07 £000s	Estimate 2007/08 £000s	Estimate 2008/09 £000s
Capital Expenditure	3,660	5,000	7,000	5,000	5,000
Financed by -					
Supported Borrowing	2,975	4,087	4,166	4,166	4,166
Unsupported Borrowing	0	913	2,834	834	834
Capital receipts	685	0	0	0	0
CFR as at 31 March	26,921	29,639	34,049	36,408	38,806
External debt as at 31 March -					
Borrowing	21,974	26,872	32,954	35,142	37,575
Other LT liabilities	780	702	618	529	434
Total debt	22,754	26,574	33,572	35,671	38,009

#### 3.3 **Limits to Borrowing Activity**

The first key control over the Authority's borrowing activity is a Prudential Indicator to ensure that over the medium term, net borrowing will only be for a capital purpose. Net external borrowing should not, except in the short-term, exceed the total Capital Financing Requirement in the preceding year plus the estimates of any additional capital financing requirement for 2005/06 and the next two financial years. This allows some flexibility for limited early borrowing for future years.

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**The Authority comfortably complied within requirement to keep net borrowing below the relevant Capital Financing Requirement in 2004/05, and no difficulties are envisaged for the current or future years.**

3.4 A further two Prudential Indicators control overall level of borrowing. These are the Authorised Limit and the Operational Boundary. The Authorised Limit represents the limit beyond which borrowing is prohibited. It reflects the level of borrowing which, while not desired, could be afforded in the short-term, but is not sustainable. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3(1) of the Local Government Act 2003.

The operational boundary is based on the probable external debt during the course of the year. It is not a limit and actual borrowing could vary around this boundary for short times during this year.

The Authority is asked to approve the following limits for its total external debt, gross of any investments. These limits separately identify borrowing from other long term liabilities such as finance leases.

	2005/06 Rev Est £m	2006/07 Estimate £m	2007/08 Estimate £m	2008/09 Estimate £m
<u>Authorised limit for external debt</u>				
Borrowing	34.3	40.4	43.5	46.6
Other long term liabilities	0.7	0.6	0.5	0.4
Total	35.0	41.0	44.0	47.0
<u>Operational boundary for external debt</u>				
Borrowing	30.3	35.4	38.5	41.6
Other long term liabilities	0.7	0.6	0.5	0.4
Total	31.0	36.0	39.0	42.0

### 3.5 Affordability Prudential Indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. The following two indicators provide an indication of the capital investment plans on the overall finances of the Authority:

#### 3.5.1 Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing costs net of investment income) against the net revenue stream (amounts met from Revenue Support Grant, local taxpayers and balances):

	Actual 2004/05	Rev Est 2005/06	Estimate 2006/07	Estimate 2007/08	Estimate 2008/09
Ratio of financing costs to net revenue stream	4.02%	4.18%	4.97%	5.16%	5.15%

Please note that the estimates for 2006/07, 2007/08 and 2008/09 are approximately .5% higher than 2005/06 due to a technical adjustment which has reduced RSG. Funding for pensions from 2006/07 is to be paid by a separate grant rather than through RSG.

#### 3.5.2 Effect on the Precept

This indicator estimates the incremental impact of capital investment decisions proposed in the budget report, over and above capital investment decisions that have been previously taken by the Authority:

	Proposed Budget 2006/07	Forward Projections	
		2007/08	2008/09
Gross increase in revenue expenditure (£000s)	158	629	1,103
Increase in Precept (Band D)	24p	97p	£1.69
Increase in expenditure net of Central Government Support (£000s)	64	184	297
Increase in Precept (Band D)	10p	28p	46p

#### 4. **REVENUE BUDGET AND MEDIUM TERM FINANCIAL PLAN**

- 4.1 It is proposed that the Authority should produce this year a three year Revenue Budget. This will accommodate not only the Prudential Guidelines but help to reflect the longer term implications of the Integrated Risk Management Plan (IRMP), which is a key component of the Corporate Plan.
- 4.2 Clearly the Authority will only be asked to approve a precept for the first year, thereby fixing only the first year of the three year plan.
- 4.3 This section of the report will set the scene for the appropriate consideration of the Revenue Budget for the three year period. The report will:-
- (i) review the level of balances likely to be available at the start of the new financial year;
  - (ii) evaluate the cost of providing the current level of service in 2006/07 – a Service Standstill;
  - (iii) review the Government's announcements in the 2005 Spending Review and in the Local Government Finance Settlement for 2006/07; and 2007/2008
  - (iv) set out the Management Board's proposed budget.

##### Review of 2005/2006

- 4.4 The Revenue Budget for 2005/06 was determined by the Authority on 18th February, 2005, after a difficult budget round. The cost of a service standstill budget was £90,2m which would have delivered a precept increase of around 12%. However as part of the Local Government Finance Settlement the government made it clear that it expected precept increases to be limited to 5% and pointedly stressed that this expectation applied to fire authorities.

As a consequence the Management Board recommended a series of savings which were principally delivered through the implementation of IRMP which coupled with a contribution from balances and use of the pension reserve allowed the Authority to deliver a precept increase of just below 5%.

Detailed monitoring reports have been presented to each meeting of the Finance and Best Value Committee during the year. The latest of these on this agenda will report project expenditure in line with the approved revenue budget leaving an estimated revenue balance of £1.8m.

## General Fund Balances

- 4.5 The Authority needs to maintain a minimum level of its General Fund balances. At its simplest, the level of working balances should be sufficient to cover the risk of costs arising from unplanned events. These would include changes in interest rates, pay awards, the possibilities of legal challenges, increased activity etc. In the event of unexpected costs arising in excess of balances, the Authority would run into a deficit which would need to be recovered from the following year's precept. The current method of calculating the minimum level of balances is to complete a risk assessment, summarising the principal risks and measures to control or limit them. The Management Board's risk assessment is shown at Appendix 2, and indicates that the minimum level of balances should be £1.2m. Whilst this is similar to the level of last year, it should be noted that the assessment of individual risks has changed. In 2005/2006 the major risk related to the repayment of transitional funding which will now be repaid through the revenue support grant settlement in 2006/2007 and 2007/2008. However the abolition of the pension reserve and means that provision needs to be included for ill health retirements and injury pensions.

## Pensions Reserve

- 4.6 With effect from 1 April 2006 the way firefighters pensions are financed will change with the current pay as you go method being replaced by an employers contribution based on 21.3% of gross pensionable pay plus an annual payment into the account based the number of ill health retirements. The ongoing effect of the change in funding will be to remove the large peaks and troughs currently caused by lump sum pension payments and thus the Authority will no longer require a separate pension reserve. The impact of the charge on grant levels is explained in paragraph 7 below.
- 4.7 The balance on the pension reserve at 1 April 2005 was £1.9m and it is currently forecast that £1.0m will be used to fund current years expenditure as planned leaving a balance of £0.9m which can be transferred into the general reserve.

The cumulative effect of the level of expenditure and the abolition of the pension reserve means there will be a general fund balance of £2.7m at the end of the year. £1.5m of which can be released to support the medium term financial plan. To avoid the 'cliff edge' **it is recommended that the balances be released over three years at the value of £750,000 in 2006/2007, £500,000 in 2007/2008 and £250,000 in 2008/2009.**

## Collection Fund Balances

- 4.8 The five West Yorkshire district councils have advised the Authority that it is entitled to shares of their Collection Fund balances, amounting in total to £313,000. This must be used to reduce fire precept in 2006/07.

## **5 REVENUE SUPPORT GRANT SETTLEMENT 2006/2007 AND 2007/2008**

- 5.1 The provisional Revenue Support Grant Settlement for 2006/2007 and 2007/2008 was announced by Central Government on 3<sup>rd</sup> December 2005 and for the first time the announcement provided information for 2 years. There have been major changes in the way FSS is calculated including the introduction of a four block system for allocating grant. The four blocks are as detailed below:-

*Relative Needs Amount* - this replaces the old FSS and is intended to reflect the need to spend to provide the service within the area.

*Relative Resources Block* – this is to reflect the ability of different authorities to raise council tax in different areas of the country.

*Central Allocation* – which is an allocation based on a per capita basis to reflect the population of the area

*Floor Damping* – which is the way the floors are funded within the different expenditure blocks

- 5.2 Firefighters Pensions

The most significant change to the formula as far as this Authority is concerned is the change in the method of financing firefighters pensions. As the Authority has been previously informed the current pay as you go system of funding is to be replaced by the establishment of a separate pension account in to which the Authority will make a contribution based on 21.3% of pensionable pay plus payments in respect of ill health pensions. The cost of injury pensions will continue to be met from within the normal revenue budget.

The net effect of these changes on the 2006/2007 revenue budget will be to reduce expenditure on pensions by £6.9m. In order to reflect this change in the annual expenditure of the authority government have adjusted fss and revenue support grant to take account of this change. **However the impact of this change in revenue support grant has resulted in a loss of grant of £8.4m leaving the authority with a net loss of grant of £1.5m.** In addition because of the way the adjustment has been calculated based on the 2005/2006 level of revenue support grant this loss of grant is not protected by the floors mechanism.

This change in pension funding has similarly effected a further 8 fire authorities and representations have been made to government including a ministerial visit by this and each of the other authorities affected. Whilst the Minister was already aware of the scale of the problem and assured the authority that this loss of grant was not intended we will not know until the final settlement whether the issue has been resolved.

### 5.3 Floor damping

Once again the government has used a system of floor damping to guarantee all authorities a minimum cash increase in grant. The floor for fire Authorities is 1.5% which reflects the phased repayment of transitional funding over the years 2006/2007/ and 2007/2008. As mentioned in the previous paragraph the floors have not protected the authority from the £1.5m loss of grant through changes to pension funding.

5.4 The government in announcing the settlement is very clear that it expects the national average increase in Council Tax will be less than 5%.

## 6 PROJECTIONS FOR 2007/08 AND 2008/09

6.1 As previously mentioned, the government have for the first time provided details of revenue support grant for 2 years (2006/7 and 2007/8) to assist in budget planning.

Table 6. Predicted grant levels 2006/2007 to 2008/09

	£m	Increase
2006/07 (provisional)	52.124	1.5%
2007/08 (provisional)	53.560	2.8%
2008/09	55.060	2.8%

The prediction for 2008/2009 is based upon a cash increase of 2.8% as received in 2007/08. However, 2008/09 is the start of a new spending period for government so it is difficult to project what impact that may have.

## 7 **A STANDSTILL BUDGET - MAINTAINING THE CURRENT LEVEL OF SERVICE**

7.1 A standstill budget has been prepared for 2006/2007, for the purposes of providing a base line from which to measure change in the proposed budget. This is calculated by updating the 2005/2006 Budget for increases in pay, prices, new financing charges, changes in pension funding and other technical adjustments. **A standstill budget for 2006/2007 would amount to £84.4m.** The changes from the 2005/2006 budget are explained in the table below:-

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Table 7. Calculation of Standstill Budget 2005/06

	£m	£m
<b>2005/2006 Revenue Budget</b>		<b>88.376</b>
<u>Adjust for inflation</u>		
Pay awards	2.082	
Price increase	0.367	2.449
Changes in the method of funding firefighters pensions	-----	-6.907
Cost of additional borrowing to fund capital investment		0.427
Changes in level of government grants and external funding		0.065
Other changes within base budget		0.028
<b>2006/2007 standstill Budget</b>		<b>84.438</b>
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## **8 PROPOSED REVENUE BUDGET 2006/07**

- 8.1 The Management Board has been asked by members to produce a draft budget which would deliver a precept increase of 5%, consistent with the government's apparent limit. Clearly the impact of this level of precept will be dependant upon the outcome of the representations on revenue support grant in relation to firefighters pensions. The Management Board is currently working on a series of options which it will present to each of the political parties based on both potential scenarios. However, based on the provisional settlement and the proposed use of balances of £750,000. The Authority will have to identify savings of £1.38m to deliver a 5% precept.

## **9 MEDIUM TERM FINANCIAL PLAN**

- 9.1 The continuing effect of these proposals into 2007/08 and 2008/09, in addition to known increases in costs, are also shown in the draft Revenue Budget. Increases in pay and prices are shown in contingency budgets so that the 'service' figures reflect the changes over the three-year period at constant prices.

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9.2 Clearly the impact of these charges on future years precept are dependant upon the proposals presented by Management Board. These will be included in the final report to the Full Authority.

## **10 TREASURY MANAGEMENT STRATEGY**

### 10.1 Background

10.1.1 The Authority is required to consider an annual Treasury Strategy Statement in accordance with CIPFA's Code of Practice on Treasury Management. As part of this strategy, the Authority not only needs to consider its future borrowing policy in light of economic and interest rate forecasts, but also needs to approve certain treasury management related Prudential Indicators as required by the Prudential Code for Capital Finance in Local Authorities, and also an investment strategy as required by regulations contained in the Local Government Act 2003.

### 10.2 BORROWING REQUIREMENT AND STRATEGY

#### *Borrowing Requirement*

10.2.1 The Authority primarily borrows to finance capital expenditure, although it also needs to facilitate day-to-day cash-flow variations. The Authority's underlying need to borrow for capital purposes is known as the Capital Financing Requirement (CFR), but it should not be expected that the Authority's level of external debt necessarily equates to this. This is because it uses internal balances, such as revenue reserves, to reduce external borrowing. It therefore follows that any expected changes in these balances will also affect the Authority's borrowing requirement.

10.2.2 After taking account of the effects of the proposed capital programme, any movements in internal balances, and long-term loan repayments, it is forecast that the Authority will have a requirement for new external borrowing of £7.0 million, £4.1 million and £3.4 million in 2006/07, 2007/08 and 2008/09 respectively. How this borrowing requirement is fulfilled is dependent on the outlook for interest rates and also the Authority's current borrowing structure.

Outlook for interest rates

10.2.3 UK growth has been substantially weaker in 2005/06 but is expected to stage a recovery in 2006/07, as consumer activity and corporate investment becomes more positive. How strong this recovery might be is very uncertain and the position is further clouded by uncertainty in the world economy. UK longer term interest rates have been influenced by US interest rates, which appear unrealistically low, and there continues to be risk of an upward shift in rates. According to our advisors, interest rate forecasts are as follows:

	Base rate	5 yr Gilts	20 yr Gilts
2005/06	4.6%	4.3%	4.5%
2006/07	4.3%	4.4%	4.6%
2007/08	4.5%	4.6%	4.7%
2008/09	4.8%	4.8%	4.7%

10.2.4 There are significant risks to the forecast, which expects positive but low world and UK economic growth. Further weakness in growth could see short- and long-term rates return to historic lows, although there is a higher probability that rates will return to historic norms and shift to a higher level.

Borrowing Structure

10.2.5 It is predicted that as at 31 March 2006, the Authority will have £24.2 million long-term and up to £1.7 million short-term borrowing. All the long-term borrowing is currently at fixed rates. The average interest rate for fixed rate loans is estimated to be 5.71% as at the end of 2006. The debt maturity profile is shown in Appendix 1.

10.2.6 All long-term loans are currently with the Public Works Loan Board.

Proposed Strategy

10.2.7 In view of the uncertainty surrounding future interest rates, it is proposed to take a pragmatic approach to how capital expenditure might be financed. The Chief Finance Officer, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time. If Base Rates stay low as forecast then new borrowing will be kept to shorter periods at variable rates. However, if opportunities arise to obtain long-term loans at levels below 4.75% then these should be considered. This may include borrowing in advance of need.

- 10.2.8 There are market loans available called LOBOs (Lender's Option Borrower's Option) which have offered exceptional value in 2005/06 with rates under 4%. The way these loans work is that the borrower pays interest at a fixed rate for an initial period and then the lender has the option in the secondary period to increase the rate. If the option is exercised, the borrower can either accept the new rate or repay the loan. These agreements typically have initial periods up to 20 years and total periods up to 60 years.
- 10.2.9 It would seem advantageous to take LOBOs if their terms better those offered by the PWLB. However, as there is some uncertainty attached to these loans, it is recommended that LOBO borrowing is limited to 10% of total long-term debt.
- 10.2.10 It is good practice to have a maturity profile for long-term debt which does not expose the Authority to a substantial borrowing requirement in years when interest rates might be at a relatively high level. In accordance with the Prudential Code, the Authority sets out limits with respect to the maturity structure of its borrowing later in this report.
- 10.2.11 The Chief Finance Officer will also look for opportunities to restructure the Authority's debt portfolio either to make savings, enhance the maturity profile and/or the balance of volatility.
- 10.2.12 Borrowing performance will be monitored continuously throughout the year and will be reported to Members as part of the annual report on Treasury Management.

### 10.3 INVESTMENT STRATEGY

- 10.3.1 Investment guidance issued by the ODPM under the 2003 Act states that an investment strategy, outlining the authority's policies for managing its investments in terms of risk, liquidity and yield, should be approved by full Authority before the start of the financial year. This strategy can then only be varied during the year by the same executive body.

#### Reasons for investing

- 10.3.2 The Authority will invest for the following reasons –
- To facilitate day-to-day cash-flow variations
  - To temporarily invest funds borrowed for capital purposes in advance of anticipated interest rate increases
  - To invest "internal funds", when it is deemed to be more prudent than to use these to reduce borrowing
- 10.3.3 For 2004/05, the Authority approved the investment of around £3 million of internal balances, so as to safeguard its future borrowing position in light of possible Central Government restrictions on external borrowing. Under the new prudential borrowing regulations, the Government have the right to

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impose restrictions on overall local authority borrowing, if it is felt to be in national economic interests. Although the method of control has not yet been clarified, it is quite possible that limits may be placed on external borrowing levels. If this is the case, authorities with low amounts of borrowing in relation to their CFR may be in a disadvantageous position.

- 10.3.4 For 2005/06, the Authority's external borrowing is forecast to be lower than its CFR by £6 million. If the Government were to set limits on new external borrowing, the Authority may be restricted as to its use of its "internal funds", including revenue balances and reserves, because their use would compel the Authority to replace them with additional borrowing. By externally investing "internal funds", the Authority increases its external borrowing and thus safeguards its position if the Government introduces a policy of borrowing restrictions.
- 10.3.5 To minimise this risk, it is recommended that the Authority invests "internal funds" of up to £4 million, which represents the estimated future level of internal balances which are of a more permanent nature. The Authority will also invest to facilitate day-to-day cash-flow variations and, if the opportunity arises, invest temporarily funds borrowed for capital purposes in advance of anticipated interest rate rises.

*Specified and Non-Specified Investments - Counterparty Criteria*

- 10.3.6 The ODPM guidance splits investments into two types – specified and non-specified:
- (i) Specified investments are those offering high security and liquidity. All such investments should be in sterling with a maturity of no more than a year. Investments made with the Government (DMADF) or a local authority automatically count as specified investments, as do investments with bodies with "high credit ratings". It is for individual authorities to determine what they regard as a "high credit rating".
  - (ii) Non-specified investments have greater potential risk, being investments with bodies that are not highly credit rated or credit rated at all, and investments over a year.

10.3.7 In line with Government guidelines and CIPFA's Code of Practice on Treasury Management, it is recommended that the Authority maintains a strategy which gives priority to security and liquidity, but also gives appropriate attention to yield. The investment policy detailed in the Appendix 2 is a continuation of previous policy, containing both specified and non-specified investment opportunities, recognising through the limits proposed, the higher risk but potential higher returns of non-specified investments.

10.3.8 In terms of specified investments, it is proposed that:

- The Authority is able to invest up to £1 million and up to a year with individual local authorities, the DMADF, and Money Market Funds/banks/building societies with a high short-term credit rating given by at least one of the main credit rating agencies (Fitch, Moody's and S&P).

10.3.9 As far as non-specified investments are concerned, it is proposed that:

- The Authority is able to invest up to £500,000 for up to 6 months with individual building societies that are not credit-rated but that have assets over £1 billion. Many building societies are able to raise sufficient funds on wholesale money markets without having credit ratings, and therefore do not go through the expensive process of acquiring and maintaining them. The building society movement as a whole has a very secure history and remains strong from both a financial and regulatory viewpoint. These building societies potentially offer higher returns.
- The Authority adopts an overall limit of £1 million at any one time for all non-specified investments.
- The Authority makes no investments longer than one year.

10.3.10 Credit ratings will be monitored continuously and revised limits/periods will be put in place immediately and applied to any new investments.

10.3.11 Investment performance will be monitored continuously throughout the year and will be reported to Members as part of the annual report on Treasury Management.

#### 10.4 TREASURY MANAGEMENT PRUDENTIAL INDICATORS

10.4.1 There are four treasury prudential indicators. The first prudential indicator is that the authority has adopted the CIPFA Code of Practice for Treasury Management in Public Services. The Authority adopted the Code at its meeting on 15 February 2002.

10.4.2 The purpose of the other indicators is to contain the activity of the treasury function within certain limits, thereby reducing the risk or likelihood of an adverse movement in interest rates or borrowing decisions impacting negatively on the Authority's overall financial position. However, if these are set to be too restrictive they will impair the opportunities to reduce costs.

Interest Rate Exposures

10.4.3 While fixed rate borrowing can contribute significantly to reducing the uncertainty surrounding future interest rate scenarios, the pursuit of optimum performance justifies retaining a degree of flexibility through the use of variable interest rates on at least part of the treasury management portfolio. The Prudential Code requires the setting of upper limits for both variable rate and fixed interest rate exposure.

10.4.4 It is recommended that the Authority sets an upper limit on its fixed interest rate exposures for 2005/06, 2006/07 and 2007/08 of 100% of its net interest payments. It is further recommended that the Authority sets an upper limit on its variable interest rate exposures for 2005/06, 2006/07 and 2007/08 of 40% of its net interest payments.

10.4.5 This means that fixed interest rate exposures will be managed within the range 60% to 100%, and variable interest rate exposures within the range 0% to 40%.

Maturity Structure of Borrowing

10.4.6 This indicator is designed to prevent the Authority having large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates. It is recommended that the Authority sets upper and lower limits for the maturity structure of its borrowings as follows:

Amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate		
	Upper limit	Lower limit
	%	%
under 12 months	15	0
between 1 and 2 years	15	0
between 2 and 5 years	45	0
between 5 and 10 years	75	0
more than 10 years	90	20

Total principal sums invested for periods longer than 364 days

10.4.7 There is no proposal for the Authority to invest sums for periods longer than 364 days.

## APPENDIX 2

### WEST YORKSHIRE FIRE AUTHORITY - INVESTMENT POLICY

	Short-Term Credit Ratings			Investment Limits per Counterparty	
	Fitch	Moody's	S&P	£m	Period (5)
<b>Specified</b>					
Bank (1)/ Building Soc	F1+ / F1	P-1	A-1+ / A-1	1	<12mth
MMF (2)	AAA	AAA	AAA	1	n/a
DMADF (3)	-	-	-	1	<12mth
Local Auths	-	-	-	1	<12mth
<b>Non-Specified (4)</b>					
Unrated Building Soc with assets >£1bn	-	-	-	.5	<6mth

- (1) For banks within a banking group, a limit of £1 million will apply to the group rather than the individual banks.
- (2) Money Market Funds are not invested with for a fixed period of time. Rather, clients use them to manage short term cash flow requirements.
- (3) The DMADF facility is the Government's deposit taking facility.
- (4) Overall limit of £1 million at any point in time.
- (5) The investment period begins from the date of the commitment to invest, rather than the date on which funds are paid over.

## 15. **RECOMMENDATIONS**

It is recommended:-

- (i) that, having considered the Prudential Indicators relating to the revenue costs of funding capital investment, members approve the proposed three-year Capital Investment Plan;
- (ii) that members approve the Prudential Indicators in respect of:-
  - (a) the Capital Financing Requirement as set out in Table 2;
  - (b) the level of External Debt also set out in Table 2;
  - (c) the Authorised Limit for external debt as set out in Table 2A;
  - (d) the Operational Boundary for external debt also set out in Table 2A;
  - (e) the upper limits on its fixed and variable interest rate exposures as set out in paragraph 14.4;
  - and (f) the limits for the maturity structure of its borrowings as set out in Table 10 of the report;
- (iii) that members approve the proposed borrowing strategy as set out in paragraphs 12.6 to 12.8 of the report;
- (iv) that members approve the proposed changes to the investment strategy as consolidated in Section 13 and Annex 2 to the report;
- (v) that members consider the Management Board's proposals for a Revenue Budget which produces a precept increase of 5% in 2005/06.

