CABINET - 18 FEBRUARY 2010

INVESTMENT STRATEGY 2010/11

Report of the:	Deputy Chief Executive and Director of Corporate Resources
Also considered by:	Finance Advisory Group – 20 January 2010
	Performance and Governance Committee - 16 February 2010
	Council – 23 February 2010
Status:	For Consideration and recommendation to Council
Key Decision:	No

Executive Summary: The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act). This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

This report supports the Key Aim of effective management of Council resources.

Portfolio Holder	Cllr. Ramsay
Head of Service	Head of Finance and Human Resources – Mrs. Tricia Marshall

Recommendations:

1. That Cabinet:

   a) Recommend Council to approve the annual Investment Strategy set out in this report; and

   b) Recommend Council to adopt the revised CIPFA Treasury Management Code of Practice 2009 and the revised Treasury Management Policy Statement (as set out in Appendices G and H).

2. Members' views are requested as to which (if any) investment counterparties could be added to the existing strategy and whether or not it is appropriate to increase individual investment limits and investment terms.

Background

1 In order to comply with the requirements of the Local Government Act 2003 and supporting regulations, the Council must prepare an annual investment strategy in advance of the forthcoming financial year. The strategy suggested in this report along with the Prudential Indicators relating to the Council's capital investment plans will also be reported to Cabinet for approval.

Introduction

The revised CIPFA Treasury Management Code of Practice 2009

2 In the light of the Icelandic situation in 2008, CIPFA has amended the CIPFA Treasury Management in the Public Services Code of Practice (the Code), Cross-Sectoral Guidance Notes and Guidance Notes and the template for the revised Treasury Management Policy Statement. It is also a requirement of the Code that this Council should formally adopt the Code. As the Code has been revised, there are separate appendices to this report where the Council is asked to adopt the revised Code and the revised Treasury Management Policy Statement.

3 The revised Code has emphasised a number of key areas including the following: -

a) All councils must formally adopt the revised Code and four clauses

b) The strategy report will affirm that the effective management and control of risk are prime objectives of the Council's treasury management activities.

c) The Council's appetite for risk must be clearly identified within the strategy report and will affirm that priority is given to security of capital and liquidity when investing funds and explain how that will be carried out.

d) Responsibility for risk management and control lies within the organisation and cannot be delegated to any outside organisation.

e) Credit ratings should only be used as a starting point when considering risk. Use should also be made of market data and information, the quality financial press, information on government support for banks and the credit ratings of that government support.

f) Councils need a sound diversification policy with high credit quality counterparties and should consider setting country, sector and group limits.

g) Borrowing in advance of need is only to be permissible when there is a clear business case for doing so and only for the current capital programme or to finance future debt maturities.

h) The main annual treasury management reports MUST be approved by full council.

i) There needs to be, at a minimum, a mid year review of treasury management strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved.

j) Each council must delegate the role of scrutiny of treasury management strategy and policies to a specific named body.

k) Treasury management performance and policy setting should be subjected to prior scrutiny.

l) Members should be provided with access to relevant training.

m) Those charged with governance are also personally responsible for ensuring they have the necessary skills and training.

n) Responsibility for these activities must be clearly defined within the organisation.

o) Officers involved in treasury management must be explicitly required to follow treasury management policies and procedures when making investment and borrowing decisions on behalf of the Council (this will form part of the updated Treasury Management Practices).

4 This strategy statement has been prepared in accordance with the revised Code. Accordingly, the Council's Treasury Management Strategy will be approved annually by the full Council and there will also be a mid year report. In addition there will be monitoring reports and regular review by Members in both executive and scrutiny functions. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

5 This Council will adopt the following reporting arrangements in accordance with the requirements of the revised Code: -

Area of Responsibility	**Council/ Committee/ Officer**	**Frequency**
Treasury Management Policy Statement (revised)	Full Council	Initial adoption in 2010
Treasury Management Strategy / Annual Investment Strategy /	Full Council	Annually before the start of the year

MRP policy		
Treasury Management Strategy / Annual Investment Strategy / MRP policy – mid year report	Full Council	Mid year
Treasury Management Strategy / Annual Investment Strategy / MRP policy – updates or revisions at other times	Full Council	As and when required
Annual Treasury Outturn Report	Full Council	Annually by 30 September after the end of the year
Treasury Management Monitoring Reports	Cabinet	Standing item
Treasury Management Practices	Cabinet	As and when required
Scrutiny of Treasury Management Strategy	Finance Advisory Group / Performance & Governance Committee	Annually before the start of the year
Scrutiny of treasury management performance	Finance Advisory Group / Performance & Governance Committee	Standing item

<u>Revised CIPFA Prudential Code</u>

6 CIPFA has also issued a revised Prudential Code which primarily covers borrowing and the Prudential Indicators. Three of these indicators have now been moved from being Prudential Indicators to being Treasury Indicators: -

- authorised limit for external debt
- operational boundary for external debt
- actual external debt.

7 However, all indicators are to be presented together as one suite. In addition, where there is a significant difference between the net and the gross

borrowing position, the risks and benefits associated with this strategy should be clearly stated in the annual strategy.

Revised Investment Guidance

8 It should also be noted that the Department of Communities and Local Government is currently undertaking a consultation exercise on draft revised investment guidance which will result in the issue of amended investment guidance for English local authorities to come into effect from 1 April 2010. A separate report will be made to Members to inform them when this guidance has been finalised. It is not currently expected that there will be any major changes required over and above the changes already required by the revised Code.

Treasury Management Strategy for 2010/11

9 The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

10 The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. The Annual Investment Strategy follows at paragraph 24 of this report.

11 The suggested strategy for 2010/11 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser, Sector Treasury Services.

12 The strategy covers:

- treasury limits in force which will limit the treasury risk and activities of the Council
- Prudential and Treasury Indicators
- the current treasury position
- prospects for interest rates
- the borrowing strategy
- the investment strategy
- creditworthiness policy

- policy on use of external service providers
- the MRP strategy (Appendix A)

Balanced Budget Requirement

13 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from: -

a) Increases in interest charges caused by increased borrowing to finance additional capital expenditure, and

b) Any increases in running costs from new capital projects are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

Treasury Limits for 2010/11 to 2012/13

14 It is a statutory duty under Section 3 of the Act and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and Wales the Authorised Limit represents the legislative limit specified in the Act.

15 The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is 'acceptable'.

16 Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years. Details of the Authorised Limit will be added to Appendix C of this report when it is presented to Cabinet next month.

Current Portfolio Position

17 The Council's treasury portfolio position at 8th January 2010 appears in Appendix K.

Prudential and Treasury Indicators for 2010/11 to 2012/13

18 Prudential Indicators (as set out in Appendix C to this report) are relevant for the purposes of setting an integrated treasury management strategy.

19 The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This original 2001 Code was adopted on

24 September 2003 by the full Council and the revised Code will be adopted on 23 February 2010.

Prospects for Interest Rates

20 The Council has appointed Sector Treasury Services as treasury adviser to the Council and part of their service is to assist the Council to formulate a view on interest rates. Appendix B draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Sector central view.

Sector Bank Rate forecast for financial year ends (March)

- 0.50%
- 1.50%
- 3.50%
- 4.50%

21 There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected. A detailed view of the current economic background is contained within Appendix D to this report.

Borrowing Strategy

22 It is anticipated that there will be no capital borrowings required during 2010/11.

Annual Investment Strategy

<u>Investment Policy</u>

23 The Council will have regard to the CLG's Guidance on Local Government Investments ("the Guidance") issued in March 2004, any revisions to that guidance, the Audit Commission's report on Icelandic investments and the 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are: -

a) the security of capital; and

b) the liquidity of its investments.

24 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investments.

25 The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

26 Investment instruments identified for use in the financial year are listed in Appendix E under the ‘Specified’ and ‘Non-Specified’ Investments categories. Counterparty limits will be as set through the Council’s Treasury Management Practices – Schedules.

Creditworthiness Policy

27 This Council uses the creditworthiness service provided by Sector Treasury Services. This service has been progressively enhanced over the last year and now uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:-

- credit watches and credit outlooks from credit rating agencies
- Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries

28 This modelling approach combines credit ratings, credit watches, credit outlooks and CDS spreads in a weighted scoring system for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments and are therefore referred to as durational bands. The Council is satisfied that this service now gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.

29 The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Sector’s weekly credit list of worldwide potential counterparties. The Council will therefore use counterparties within the following durational bands:-

- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No Colour Not to be used

30 This Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy

counterparties as Moodys are currently very much more aggressive in giving low ratings than the other two agencies. This would therefore be unworkable and leave the Council with few banks on its approved lending list. The Sector creditworthiness service does though, use ratings from all three agencies, but by using a scoring system, does not give undue preponderance to just one agency's ratings.

31 All credit ratings will be monitored on a weekly basis. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service and a newsflash system exists to alert the Council to any immediate issues arising.

- If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

- In addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list.

32 Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and information, information on government support for banks and the credit ratings of that government support.

<u>Country Limits</u>

33 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide) The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix F. This list will be added to or deducted from by officers should ratings change in accordance with this policy.

34 In addition, the Council has previously decided to limit investment to counterparties from the UK and the EU.

<u>Other Creditworthiness Issues</u>

35 As far as building societies are concerned, there is only one that meets the Sector criteria.

36 The Council's current investment policy further limits the one proposed by Sector as follows:-

- Minimum long term credit rating of AA-.

- Investments are limited to 15% of the total fund to any single institution or institutions within a group of companies.

- Total investments in any one foreign country is limited to 15% of the total fund.
- Investments are limited to £2m per counterparty.
- Lending to nationalised and government majority owned banks is limited to £4m per group and to £2m per institution within that group with similar limits to banks within the Santander group.

37 Amendments to the current policy are proposed later in this report.

Investment Strategy

38 The Council's investment portfolio consists largely of a core balance available for investment over a 2-3 year period or longer, if required, plus cash-flow derived balances. The value of the portfolio at 8th January 2010 is £29.9 million (including £1 million with Landsbanki). Investments will accordingly be made with reference to the core balance and cash-flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

39 **Interest rate outlook**: Bank Rate has been unchanged at 0.50% since March 2009. Bank Rate is forecast to commence rising in quarter 3 of 2010 and then to rise steadily from thereon. Bank Rate forecasts for financial year ends (March) are as follows: -

- 2010 0.50%
- 2011 1.50%
- 2012 3.50%
- 2013 4.50%

40 There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected.

41 The Council will avoid locking into longer term deals while investment rates are down at historically low levels unless exceptionally attractive rates are available which make longer term deals worthwhile.

42 For 2010/11 it is suggested that the Council should budget for an investment return of 1.00% on investments placed during the financial year.

43 For its cash flow generated balances, the Council will seek to utilise its business reserve accounts and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

End of year investment report

44 At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

Policy on the use of external service providers

45 The Council uses Sector Treasury Services as its external treasury management advisers.

46 The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

47 It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

Scheme of delegation

48 The guidance notes accompanying the revised Code also require that a statement of the Council's scheme of delegation in relation to treasury management is produced as part of the Annual Investment Strategy. This appears at Appendix I.

Role of the Section 151 officer

49 As with the scheme of delegation mentioned in the previous paragraph, a statement of the role of the Section 151 officer is also required. This appears at Appendix J.

Options for future investment policy

50 The creditworthiness issues mentioned in paragraphs 28 to 37 have severely restricted the ability to find suitable counterparties over the last few months, resulting in a larger than usual balance being held in an instant access account. For short periods in most of the recent months in excess of £10m has been held there.

51 In order to reduce reliance on this account, it is suggested that certain relaxations of the current policy be proposed for consideration by Cabinet:-

a) Increase the single institution limit from 15% to 20%

b) Increase the foreign country limit from 15% to 20%

c) Increase single counterparty limits from £2m to £3m and group limits to £6m

d) Re-introduce lending to building societies not otherwise meeting Sector's creditworthiness criteria. Sector issued a discussion paper on this subject in October 2009, which was originally circulated to Members at the time and which can be forwarded to individual Members again, if required. The top ten building societies ranked by total assets each had assets close to or in excess of £5bn at the end of 2008. The building societies in question are Nationwide, Britannia, Yorkshire, Coventry, Chelsea, Skipton, Leeds, West Bromwich, Principality and Norwich & Peterborough. The suggested limit for each of these could be £2m with a maximum duration limit of 6 months.

52 Members views are sought on these options in order to provide additional scope for investment.

Key Implications

Financial

53 The management of the Council's investment portfolio and cash-flow generated balances plays an important part in the financial planning of the authority. The security of its capital and liquidity of its investments is of paramount importance.

54 There are financial implications arising from the restriction of the Council's lending list in that an inferior rate of interest may have to be accepted on a particular investment if some of the smaller and lower-rated institutions have been removed from the list.

Community Impact and Outcomes

55 There are no community impacts arising from this report.

Legal, Human Rights etc.

56 This report satisfies the requirements of the Local Government Act 2003 and supporting regulations plus the Council's Financial Procedure Rules which both require the preparation of an annual treasury strategy.

Conclusions

57 The effect of the proposals set out in this report is to allow the Council to effectively and efficiently manage cash balances.

58 In line with the revised CIPFA Code of Practice on Treasury Management, the annual treasury strategy must be considered by Council and this is planned for its meeting on 23 February 2010. Given the current uncertainties in the banking sector, the Council may need to consider amending its strategy during the year.

Risk Assessment Statement

59 Treasury Management has two main risks :

a. Fluctuations in interest rates can result in a reduction in income from investments; and

b. A counterparty to which the Council has lent money fails to repay the loan at the required time.

60 These risks are mitigated by the annual investment strategy which has been prepared on the basis of achieving the optimum return on investments commensurate with the proper levels of security and liquidity. However Members should recognise that in the current economic climate these remain significant risks.

Sources of Information:	Existing treasury counterparty list
	Treasury Management Strategy Statement for 2010/11 provided by Sector Treasury Services Ltd.
	CIPFA – Prudential Code on Treasury Management
	ODPM (now DCLG) – Guidance on Local Government Investments (March 2004)
	CIPFA Treasury Management in the Public Services Code of Practice (Revised 2009)
	Audit Commission’s report on Icelandic investments (March 2009)
Contact Officer(s):	Roy Parsons ext.7204

Dr. Pav Ramewal
Deputy Chief Executive and Director of Corporate Resources

Minimum Revenue Provision – an introduction

1. What is a Minimum Revenue Provision?

Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. It would be impractical to charge the entirety of such expenditure to revenue in the year in which it was incurred therefore such expenditure is spread over several years in order to try to match the years over which such assets benefit the local community through their useful life. The manner of spreading these costs is through an annual Minimum Revenue Provision, which was previously determined under Regulation, and will in future be determined under Guidance.

2. New statutory duty

Statutory Instrument 2008 no. 414 s4 lays down that:

"A local authority shall determine for the current financial year an amount of minimum revenue provision that it considers to be prudent."

The above is a substitution for the previous requirement to comply with regulation 28 in S.I. 2003 no. 3146 (as amended).

There is no requirement to charge MRP where the Capital Financing Requirement is nil or negative at the end of the preceding financial year.

The share of Housing Revenue Account CFR is not subject to an MRP charge.

3. New Government Guidance

Along with the above duty, the Government issued new guidance in February 2008 which requires that a Statement on the Council's policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which the provision will relate.

The Council is legally obliged to "have regard" to the guidance, which is intended to enable a more flexible approach to assessing the amount of annual provision than was required under the previous statutory requirements. The guidance offers four main options under which MRP could be made, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. The requirement to 'have regard' to the guidance therefore means that: -

1. Although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent.

2. It is the responsibility of each authority to decide upon the most appropriate method of making a prudent provision, after having had regard to the guidance.

Option 1: Regulatory Method

Under the previous MRP regulations, MRP was set at a uniform rate of 4% of the adjusted CFR (i.e. adjusted for “Adjustment A”) on a reducing balance method (which in effect meant that MRP charges would stretch into infinity). This historic approach must continue for all capital expenditure incurred in years before the start of this new approach. It may also be used for new capital expenditure up to the amount which is deemed to be supported through the SCE annual allocation.

Option 2: Capital Financing Requirement Method

This is a variation on option 1 which is based upon a charge of 4% of the aggregate CFR without any adjustment for Adjustment A, or certain other factors which were brought into account under the previous statutory MRP calculation. The CFR is the measure of an authority’s outstanding debt liability as depicted by their balance sheet.

Option 3: Asset Life Method.

This method may be applied to most new capital expenditure, including where desired that which may alternatively continue to be treated under options 1 or 2.

Under this option, it is intended that MRP should be spread over the estimated useful life of either an asset created, or other purpose of the expenditure. There are two useful advantages of this option: -

- Longer life assets e.g. freehold land can be charged over a longer period than would arise under options 1 and 2.
- No MRP charges need to be made until the financial year after that in which an item of capital expenditure is fully incurred and, in the case of a new asset, comes into service use (this is often referred to as being an ‘MRP holiday’). This is not available under options 1 and 2.

There are two methods of calculating charges under option 3:

a. equal instalment method – equal annual instalments,

b. annuity method – annual payments gradually increase during the life of the asset.

Option 4: Depreciation Method

Under this option, MRP charges are to be linked to the useful life of each type of asset using the standard accounting rules for depreciation (but with some exceptions) i.e. this is a more complex approach than option 3.

The same conditions apply regarding the date of completion of the new expenditure as apply under option 3.

4. Date of implementation

The previous statutory MRP requirements cease to have effect after the 2006/07 financial year. However, the same basis of 4% charge may continue to be used without limit until the 2010/11 financial year, relative to expenditure incurred up to 31/3/2009.

In general it is recommended that authorities should adopt the recommendations contained within the guidance. However, in certain cases the guidance may recommend a useful life period/MRP for expenditure which it may not be considered appropriate to adopt. It is suggested that full details of MRP options/principles adopted should be set out and approved as part of the annual MRP Policy Statement.

Minimum Revenue Provision Policy Statement 2010/11

The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2009/10, and will assess its MRP for 2010/11 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

As the Council's Capital Financing Requirement is nil or negative, there will be no requirement to charge MRP in 2010/11.

INTEREST RATE FORECASTS

The data below shows a variety of forecasts published by a number of institutions. The first three are individual forecasts including those of UBS and Capital Economics (an independent forecasting consultancy). The final one represents summarised figures drawn from the population of all major City banks and academic institutions.

The forecast within this strategy statement has been drawn from these diverse sources and officers' own views.

1. INDIVIDUAL FORECASTS

Sector interest rate forecast – 23.11.09

	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
Bank rate	0.50%	0.50%	0.50%	0.75%	1.00%	1.50%	2.25%	2.75%	3.25%	3.50%	3.75%	4.25%	4.25%	4.50%
5yr PWLB rate	2.85%	3.05%	3.20%	3.30%	3.40%	3.60%	3.85%	4.15%	4.55%	4.60%	4.80%	4.80%	4.85%	4.85%
10yr PWLB rate	3.90%	4.00%	4.05%	4.15%	4.30%	4.45%	4.60%	4.80%	4.90%	5.00%	5.10%	5.10%	5.15%	5.15%
25yr PWLB rate	4.40%	4.55%	4.65%	4.70%	4.80%	4.90%	5.00%	5.05%	5.10%	5.20%	5.30%	5.30%	5.35%	5.35%
50yr PWLB rate	4.45%	4.60%	4.70%	4.75%	4.90%	5.00%	5.10%	5.15%	5.20%	5.30%	5.40%	5.40%	5.45%	5.45%

Capital Economics interest rate forecast – 5.11.09

	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
5yr PWLB rate	2.85%	2.65%	2.15%	2.15%	2.15%	2.15%	2.15%	2.15%	2.15%
10yr PWLB rate	3.75%	3.15%	2.65%	2.65%	2.65%	2.65%	2.65%	2.65%	2.65%
25yr PWLB rate	4.25%	3.95%	3.75%	3.75%	3.75%	3.75%	3.75%	3.75%	3.75%
50yr PWLB rate	4.35%	4.15%	4.05%	4.05%	4.05%	4.05%	4.05%	4.05%	4.05%

UBS interest rate forecast (for quarter ends) – 30.10.09

	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
Bank Rate	0.50%	0.50%	0.50%	0.75%	1.00%	1.50%	2.00%	2.50%	3.00%
10yr PWLB rate	3.75%	3.90%	4.05%	4.40%	4.75%	4.90%	5.15%	5.40%	5.40%
25yr PWLB rate	4.40%	4.45%	4.65%	5.00%	5.15%	5.40%	5.65%	5.90%	5.90%
50yr PWLB rate	4.50%	4.55%	4.75%	5.10%	5.25%	5.50%	5.75%	6.00%	6.00%

2. SURVEY OF ECONOMIC FORECASTS

HM Treasury – summary of forecasts of 23 City and 12 academic analysts for Q4 2009 and 2010 published in November 2009. Forecasts for 2010 – 2013 are based on 21 forecasts in the last quarterly forecast – November 2009.

BANK RATE FORECASTS		quarter ended		annual average Bank Rate			
	actual	Q4 2009	Q4 2010	ave. 2010	ave. 2011	ave. 2012	ave. 2013
Median	0.50%	0.50%	1.30%	0.70%	1.80%	3.00%	3.70%
Highest	0.50%	0.50%	2.30%	1.30%	3.30%	4.30%	4.60%
Lowest	0.50%	0.50%	0.50%	0.50%	0.50%	1.00%	1.40%

PRUDENTIAL INDICATORS

PRUDENTIAL INDICATOR	2008/09	2009/10	2010/11	2011/12	2012/13
(1). EXTRACT FROM BUDGET AND RENT SETTING REPORT	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
	actual	**probable outturn**	**estimate**	**estimate**	**estimate**
Capital Expenditure	£1,032	£1,910	£1,256	£1,177	£1,177
Ratio of financing costs to net revenue stream	-10%	-4%	-1%	-2%	-3%
Net borrowing requirement					
brought forward 1 April	£0	£0	£0	£0	£0
carried forward 31 March	£0	£0	£0	£0	£0
in year borrowing requirement	£0	£0	£0	£0	£0
Capital Financing Requirement as at 31 March	£0	£0	£0	£0	£0
Annual change in Cap. Financing Requirement	£0	£0	£0	£0	£0
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**	**£ p**	**£ p**
Increase in council tax (band D) per annum	£0.00	£0.00	£0.03	£-0.05	£-0.05

Item No. 6b - Appendix 4, Appendix C

PRUDENTIAL INDICATOR	2008/09	2009/10	2010/11	2011/12	2012/13
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
	actual	**probable outturn**	**estimate**	**estimate**	**estimate**
Authorised Limit for external debt -					
borrowing	£5,000	£5,000	£5,000	£5,000	£5,000
other long term liabilities	£0	£0	£0	£0	£0
TOTAL	£5,000	£5,000	£5,000	£5,000	£5,000
Operational Boundary for external debt -					
borrowing	£0	£0	£0	£0	£0
other long term liabilities	£0	£0	£0	£0	£0
TOTAL	£0	£0	£0	£0	£0
Upper limit for fixed interest rate exposure					
Net principal re fixed rate borrowing / investments	100%	100%	100%	100%	100%
Upper limit for variable rate exposure					
Net principal re variable rate borrowing / investments	50%	50%	50%	50%	50%
Upper limit for total principal sums invested for over 364 days	£15,000	£15,000	£10,000	£10,000	£10,000

Maturity structure of fixed rate borrowing during 2010/11	upper limit	lower limit
under 12 months	0%	0%
12 months and within 24 months	0%	0%
24 months and within 5 years	0%	0%
5 years and within 10 years	0%	0%
10 years and above	0%	0%

ECONOMIC BACKGROUND

1.1. Introduction

- The credit crunch storm of August 2007 eventually fed through to the near collapse of the world banking system in September 2008. This then pushed most of the major economies of the world into a very sharp recession in 2009 accompanied by a dearth of lending from banks anxious to rebuild their weakened balance sheets. Many governments were forced to recapitalise and rescue their major banks and central banks precipitately cut their central bank rates to 0.10 – 1.00% in order to counter the recession.

- The long awaited start of growth eventually came in quarter 3 2009 in the US and the EU. However, there was disappointment that the UK failed to emerge from recession in quarter 3.

- Inflation has plunged in most major economies and is currently not seen as being a problem for at least the next two years due to the large output gaps and high unemployment putting a lid on wage growth. In many countries there have been widespread pay freezes in 2009 and these are likely to be persistent for some time.

- Deflation could become a threat in some economies if they were to go into a significant double dip recession.

- Asian countries, especially China, are buoying world demand through their own stimulus measures.

- There still needs to be a radical world rebalancing of excess savings rates by cash rich Asian and oil based economies and excess consumption rates in Western economies if the world financial system is not to avoid a potential rerun of this major financial crisis in years to come.

- Most major economies have resorted to a huge expansion of fiscal stimulus packages in order to encourage a fast exit from recession. This, together with expenditure on direct support provided to ailing banks, has led to a drastic expansion in government debt levels which will take many years to eliminate and to restore the previous health of national finances.

1.2 Two growth scenarios

- The current big issue is 'how quickly will the major world economies recover?' There is a sharp division of opinion on this question as set out below. The knock on effects on forecasts for interest rates can be seen in Appendix B – UBS forecast a strong recovery, Capital Economics forecast a weak recovery.

1.2.1 Strong recovery

- This is a normal cyclical recovery which will be strong in the major world economies. The US still has potential to add further fiscal stimulus in 2010 to ensure that strong recovery continues after the current round of stimulus measures end. Growth in the EU is likely to be strong in 2010 and not require such help.

The UK:

- GDP growth will almost get back to the long term average of about 2.5% in 2011 but is likely to peak in the first half of the year as inventory rebuilding and stimulus measures fade and fiscal contraction kicks in later in the year.

- The economy will rebalance with strong growth in exports and import substitution helped by strong recovery in the EU and the rest of the world.

- Sterling has depreciated by 25% since the peak in 2007 and is likely to stay weak.

- Consumer spending – only a mediocre recovery is expected due to a steady increase in the savings ratio from +5.6% in 2009 to about 8% in 2011 as consumers pay down debt or build cash balances. Consumer incomes will be held down by wage freezes and increases in taxation.

- House price recovery is expected to persist helped by a low Bank Rate for a prolonged period; the peak to trough fall in house prices is now expected to be no more than 20%. House prices to rise by about 6% in 2010, and 3% in 2011; mortgage approvals will rise back to the level of 75 - 80,000 per month needed to ensure a continuation of a trend of rising house prices.

- CPI inflation to peak @ 2.5% in early 2010 after the rise in VAT in January but then to fall to a trough near 1.5% in early 2011 and to stay below 2% for the rest of 2011.

- The current MPC attitude is one of hang on as long as possible before increasing Bank Rate. The aim of this would be to try to ensure that growth gets going at a decent rate and that Bank Rate gets back to 4 – 5% before the next recession and that all assets purchased through QE have been sold off by then. The first Bank Rate increase is expected in Q3 2009.

- If a Conservative Government comes to power in 2010 with a more aggressive fiscal approach then this could delay the timing of Bank Rate starting to go up.

- The fiscal deficit is 6.4% of GDP, about £90bn, which is expected to fall at £11bn p.a. over eight years at currently planned rates. This is similar to the peak deficit of 7% in 1990s which was remedied to a surplus of 1.6% in the space of 6 years helped by strong, steady economic growth of 3% p.a. supported by loose monetary policy that compensated for the fiscal squeeze.

- Gilt yields, especially longer term ones, are currently artificially low due to the Bank of England's Quantitative Easing operations. £200bn of gilts, commercial bonds and paper are being purchased under this scheme which has inflated prices and depressed yields. Once this campaign ends, yields will inevitably rise but will also rise due to the huge level of issuance of new gilts to finance the fiscal deficit. Long gilt yields are therefore forecast to reach 6% during 2011.

- Gilt yields could rise higher if there was a hung Parliament in 2010 or if the fiscal situation deteriorates further.

- The major risk to this scenario would be a lack of supply of bank credit. However, it is felt that the Bank of England is on alert to ensure that this does not happen and would continue various measures to assist the expansion of credit.

1.2.2 Weak recovery

- The current economic cycle is not a normal business cycle but a balance sheet driven cycle. Over borrowed banks, corporates and consumers are focused on shrinking their levels of borrowing to more viable and affordable levels and this balance sheet adjustment will take several years to be effected. Repayment of debt will therefore act as a major head wind to the required increase in demand in the economy. Consequently there will only be weak economic recovery over the next few years after the initial sharp inventory rebuilding rebound fades. GDP growth is forecast to reach only +1.5% in 2011.

- Fiscal contraction will further dampen economic recovery driven by a strong political agenda to accelerate cuts in expenditure and increases in taxation after the general election in 2010.

- The consumer savings ratio will rise so as to eliminate over borrowing and to insure against people losing their jobs during this downturn. This will depress consumer expenditure, the main driver of the UK economy.

- Growth will also be hampered by a reduced supply of credit from weakened banks compounded by weak demand for credit.

- The eventual reversal of Quantitative Easing will take cash out of the economy and reduce demand in the economy.

- Unemployment is likely to rise to near to 3m in 2010 and take years to subside due to weak growth. High unemployment will reduce tax income and increase expenditure on benefits and the costs of local authority services.

- Inflation will not be a threat for several years as the current 6% output gap will take until 2014 to be eliminated.

- However, deflation is a major danger for some years: the major falls in manufacturing prices over the last 12 -18 months have still to feed through to the economy and then to impact wage deflation.

- CPI inflation will blip up over 2% in early 2010 but will then be on a strong downward trend to about -1% in 2011.

- There is no need for the MPC to change Bank Rate from 0.5% in 2010 or 2011 and possibly for 5 years as they will need to counter the fiscal contraction which will dampen demand in the economy.

- Long PWLB rates will FALL from current levels to near 4% in 2010 due to weak economic recovery and minimal inflation so that the real rate of return (net of inflation) on long gilts is healthy at these low levels

1.2.3 Sector view

- Sector recognises that at the current time it is difficult to have confidence as to exactly how strong the UK economic recovery will prove to be. Both the above scenarios are founded on major assumptions and research which could or could not turn out to be correct.
- Sector has adopted a more moderate view between these two scenarios outlined above i.e. a moderate return to growth.
- We do, however, feel that the risks that long term gilt yields and PWLB rates will rise markedly are high.
- There are huge uncertainties in all forecasts due to the major difficulties of forecasting the following areas: -
  - degree of speed and severity of fiscal contraction after the general election
  - timing and amounts of the reversal of Quantitative Easing,
  - speed of recovery of banks' profitability and balance sheet imbalances
  - changes in the consumer savings ratio
  - rebalancing of the UK economy towards exporting and substituting imports
- The overall balance of risks is weighted to the downside i.e. the pace of economic growth disappoints and Bank Rate increases are delayed and / or lower
- There is an identifiable risk of a double dip recession and deleveraging creating a downward spiral of falling demand, falling jobs and falling prices and wages leading to deflation but this is considered to be a small risk and an extreme view at the current time on the basis of current evidence

SPECIFIED AND NON-SPECIFIED INVESTMENTS

All such investments will be sterling denominated, with maturities up to a maximum of one year, meeting the minimum 'high' rating criteria where applicable.

1. Specified Investments

	Minimum 'High' Credit Criteria	**Maximum maturity period**
Debt Management agency Deposit Facility	-	6 months
Term deposits – other LA's	-	1 year
Term deposits - banks	Long-Term AA- or better	1 year
Term deposits – building societies	Long-Term AA- or better	1 year

2. Since the credit crunch there have been a number of developments which require separate consideration and approval for use:

- **Nationalised banks** in the UK have credit ratings which do not conform to the credit criteria usually used by local authorities to identify banks which are of high credit worthiness. In particular, as they no longer are separate institutions in their own right, it is impossible for Fitch to assign them an individual rating for their stand alone financial strength. Accordingly, Fitch have assigned an F rating which means that at a historical point of time, this bank failed and is now owned by the Government. However, these institutions are now recipients of an F1+ short term rating as they effectively take on the creditworthiness of the Government itself i.e. deposits made with them are effectively being made to the Government. They also have a support rating of 1; in other words, on both counts, they have the highest ratings possible.

- **Blanket guarantees on all deposits**. Some countries have supported their banking system by giving a blanket guarantee on ALL deposits e.g. Ireland and Singapore. Authorities may view that the sovereign rating of that country then takes precedence over the individual credit ratings for the banks covered by that guarantee. Authorities need to decide if they wish to rely on these blanket guarantees to authorise lending to banks covered by these guarantees and for which countries they are prepared to do so.

- **UK banking system support package**. It should be noted that the UK Government has NOT given a blanket guarantee on all deposits but has underlined its determination to ensure the security of the UK banking system by supporting eight named banks with a £500bn support package. Again, authorities need to decide if they wish to authorise lending to those named banks on the basis of that implicit guarantee on local authority deposits placed with these eight banks or to rely on the credit ratings of the individual banks.

- **Other countries**. Authorities will also need to decide if they wish to rely on this implicit guarantee for the banking systems of other countries. The US, countries within the EU and Switzerland (and other countries) are currently providing major support packages to their banking systems.

3. At its meeting in December 2008, Cabinet decided only to lend to UK and EU institutions. Lending criteria remain to be determined on an institution's own credit ratings rather than any Government guarantees (implicit or otherwise).

	Minimum Credit Criteria	**Maximum Maturity Period**
The following categories of investment may have variable interest rates and/or variable maturity dates.		
Certificates of deposit issued by banks and building societies covered by UK Government guarantee	Banks: Long-term AA- or better Building Societies: Long-term AA- or better	1 year
Certificates of deposit issued by banks and building societies NOT covered by UK Government guarantee	Banks: Long-term AA- or better Building Societies: Long-term AA- or better	1 year
UK Government gilts	Long-term AAA	1 year
Bonds issued by multilateral development banks	Long-term AAA	1 year
Bonds issued by a financial institution which is guaranteed by the UK Government	Long-term AAA	1 year
Sovereign bond issues (i.e. other than UK Government	Long-term AAA	1 year

Treasury bills	-	3 months
Money Market Funds	Long-term AAA	1 year

4. Non-Specified Investments

A maximum of 75% will be held in aggregate in non-specified investment.

	Minimum Credit Criteria	**Max % of total investments**	**Max. Maturity period**
Term deposits – other LA's (with maturities in excess of 1 year)	-	75	5 years
Term deposits – Banks (with maturities in excess of 1 year)	Long-term AA- or better	75	5 years
Term deposits – building societies (with maturities in excess of 1 year)	Long-term AA- or better	75	5 years
Fixed term deposits with variable rate and variable maturities: Structured deposits	Long-term AA- or better	25	5 years
Certificates of deposits issued by banks and building societies	Banks: Long-term AA- or better Building Societies: Long-term AA- or better	25	5 years
UK Government Gilts	Long-term AAA	25	5 years
Bonds issued by multilateral development banks	Long-term AAA	25	5 years

Bonds issued by a financial institution which is guaranteed by the UK Government	Long-term AAA	25	5 years
Sovereign bond issues (i.e. other than the UK Govt)	AAA	25	5 years
Corporate Bonds: **the use of these investments would constitute capital expenditure**	Long-term AAA	25	5 years

APPROVED COUNTRIES FOR INVESTMENTS

AAA

- Canada
- Denmark
- Finland
- France
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland
- U.K.
- U.S.A.

AA+

- Australia
- Belgium

AA

- Hong Kong
- Japan
- Kuwait
- Portugal

AA-

- Italy
- Qatar (AA- S&P rating)

- Republic of Ireland *
- Saudi Arabia

** Sector has suggested not to lend to Irish banks as the Irish economy and banking system are under severe pressure*

TREASURY MANAGEMENT POLICY STATEMENT

This organisation defines its treasury management activities as: "The management of the authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".

61 This organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

62 This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management."

ADOPTION OF THE REVISED CIPFA TREASURY MANAGEMENT CODE OF PRACTICE 2009

INTRODUCTION

The CIPFA Code of Practice on Treasury Management in Local Authorities was last updated in 2001 and has been revised in 2009 in the light of the default by Icelandic banks in 2008. The revised Code requires that a report be submitted to the Council, board or other appropriate body, setting out four amended clauses which should be formally passed in order to approve adoption of the new version of the Code of Practice and Cross-Sectoral Guidance Notes.

63 The revised Code also includes an amended version of the treasury management policy statement (TMPS) incorporating just three clauses and a revised definition of treasury management activities. The Code does not require this statement to be approved by the council, board or other appropriate body.

64 The revised Code has also set out various requirements which have been summarised in paragraph 9 of the main report which sets out the latest Treasury Management Strategy Statement.

RESOLUTIONS

65 CIPFA recommends that all public service organisations adopt, as part of their standing orders, financial regulations, or other formal policy documents appropriate to their circumstances, the following four clauses:-

a) This organisation will create and maintain, as the cornerstones for effective treasury management:

- a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities
- suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the Code's key principles.

b) The Council will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.

c) This organisation delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Cabinet and for the execution and administration of treasury management decisions to the Deputy Chief Executive and Director of Corporate Resources, who will act in accordance with the organisation's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

d) This organisation nominates the Performance and Governance Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

TREASURY MANAGEMENT SCHEME OF DELEGATION

Council

- receiving and reviewing reports on treasury management policies, practices and activities
- approval of annual strategy

Cabinet

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices
- budget consideration and approval
- approval of the division of responsibilities
- receiving and reviewing regular monitoring reports and acting on recommendations
- approving the selection of external service providers and agreeing terms of appointment

Performance and Governance Committee

- reviewing the treasury management policy and procedures and making recommendations to the Cabinet

THE TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER

The Section 151 Officer is responsible for:-

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers