

COUNCIL	Paper No. 9(3)
Meeting date: 18 February 2010	
From: Deputy Leader and Corporate Director - Resources	

TREASURY MANAGEMENT STRATEGY FOR 2010/11

PART A - RECOMMENDATION OF CABINET MEMBER

1.0 EXECUTIVE SUMMARY

- 1.1 ***The Local Government Act 2003 and the CIPFA Code of Practice on Treasury Management require the Council to set out its annual strategy for all treasury activities.***
- 1.2 ***The report provides an update for Treasury Management activity in 2009/10 and sets out the draft Treasury Strategy for 2010/11 for the management of:***
 - ***The Council's debt - £295.2m***
 - ***The Council's investments - £93.4m at 31 December 2009***
 - ***Net Interest Budget - £33.773m***
- 1.3 ***The Strategy details the expected activities of the Treasury function in the forthcoming financial year. It determines the appropriate level of borrowing to support the capital programme and the investment decisions that will be required during 2010/11. These decisions will be taken in the light of anticipated movement in short-term and long-term interest rates, the main objectives being to minimise interest costs and manage risk effectively. The final decisions about long term borrowing will be dependant on the decisions made in the revenue and capital budget reports.***
- 1.4 ***It is a statutory requirement, under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget, taking particular account of the revenue costs which flow from capital financing decisions. The CIPFA Code, revised in 2006, clarifies that compliance with this statute must be reported in the Annual Strategy Statement.***

- 1.5 ***The Annual Investment Strategy, specifically details the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.***
- 1.6 ***The Local Government Act 2003 includes the Prudential Code which requires the Council to assess its capital investment plans and ensure they are affordable, prudent and sustainable. This must be substantiated by the production of prudential indicators, which cover capital investment and treasury management activities for the forthcoming three years.***
- 1.7 ***The report sets out the revised prudential indicators for 2009/10 and the estimates for 2010/11 to 2012/13. Further work is underway to incorporate the impact of the waste management and CNDR projects and the prudential indicators will be revised for Council.***

2.0 STRATEGIC PLANNING AND EQUALITY IMPLICATIONS

- 2.1 ***This report links to the Better theme of the Council Plan as effective management of financial resources is a pre-requisite for making informed decisions when planning and delivering Council services.***
- 2.2 ***Effective treasury management reduces costs and frees up resources for front line services.***
- 2.3 ***The draft strategy reflects the activity levels proposed in the 2010/11 draft revenue and capital budgets.***
- 2.4 ***Activity in 2009/10 has generated revenue savings of £760, with further work required to quantify possible additional savings.***

3.0 RECOMMENDATION

- 3.1 ***Council to approve:***
 - a) ***The adoption of the Treasury Management Strategy at Appendix A.***
 - b) ***The adoption of the Annual Investment Strategy Statement at Appendix A.***
 - c) ***The Prudential Indicators at Annex 3.***
 - d) ***The Minimum Revenue Provision policy at Annex 1.***

PART B – ADVICE OF CORPORATE DIRECTOR – RESOURCES

4.0 BACKGROUND

- 4.1 The report sets out the background and expected context for treasury management activity in the year ahead, including the parameters for borrowing and investment, against the economic background and the continuing impact of the credit crunch.
- 4.2 Treasury activities have continued to receive significant attention during 2009 with the continuing impact of the 'credit crunch' and the expected public sector resource constraints.

Borrowing strategy

- 4.3 The borrowing requirement for 2010/11 is dependent on decisions made about both the revenue and capital budgets. However, the strategy currently includes the need to borrow £70m, to fund the capital programme and further borrowing for equal pay. Equal pay and schools borrowing will be charged to the Equal Pay Reserve and Dedicated Schools Grant.
- 4.4 The Council borrows in the main part from the Public Works Loans Board. Borrowing will be undertaken so as to take advantage of interest rate movements and to spread the Council's borrowing over the long term. Over the next few months the Council may well look to borrow relatively short term as these interest rates are significantly below longer term rates. The Council's borrowing profile would allow for additional shorter term borrowing without leading to significant repayment/need for re-borrowing over the next ten years or so. The Council will also consider what internal resources are available and so postpone external borrowing.
- 4.5 The Council's triggers for borrowing are:
- Up to 10 years – 4.05%
 - 10 to 25 years – 4.65%

Investment strategy

- 4.6 The report sets out the proposed Investment Strategy for 2010/11. It can be difficult to estimate the Council's cash balances in light of the usual volatility of budgets such as Winter Maintenance, a particular issue for 2009/10, and the Capital Programme and there remains considerable uncertainty surrounding a further round of Equal Pay settlements. For every £1m variance in our cash balances our investment income could change by £9k. It must also be recognised that any estimates are inevitably subject to uncertainty with regard to the investment rates available. Interest rates for investment income are estimated at 0.9% for 2010/11.

- 4.7 Cumbria's investment strategy has always been relatively risk averse. The Council has developed a prescriptive list of counterparties for its investments, observing Fitch ratings. Limits are placed on the amount that can be invested and the period of investment. Funds are placed with the highest rated counterparties in the first instance. The continuing financial difficulties have reinforced this practice. Credit ratings do not necessarily provide the full picture and the Treasury Management team uses its collective judgement in determining long term borrowing and where to invest cash surpluses.
- 4.8 The current counterparty list continues to make it difficult to place the cash balances efficiently. On many occasions the Council has had to deposit significant monies with the UK Government's Debt Management Office, generating a return of only 0.25%.
- 4.9 The Council has a number of instant access accounts available to use. These are with UK banks and the returns vary from 0.75% to 0.80%. By increasing the limit for these instant access accounts, it will support the strategy of keeping a significant level of liquidity to deal with the huge uncertainty of the cashflow, but will also add up to 0.5% to the investment income return.
- 4.10 The Council uses Sector Treasury Services as its treasury adviser. As part of the service it provides a credit rating service for the assessment of counterparties which the Council uses as a basis for maintaining its counterparty lending list. Sector recently amended its rating structure to incorporate the use of Credit Default Swaps (CDS) data as an early warning indicator of banks increasing (or decreasing) their risk, alongside the information from three credit rating agencies - Fitch, Moody's and S&P.
- 4.11 In summary the following table sets out the Council's proposed approach for investments:

Proposed New Limits

Follow the colour groupings for duration advised by Sector

<p>Purple - deposits limited to 20% of expected cash balances per counterparty, for duration of up to 2 years. Subject to over-riding maximum of £20m per counterparty group. Currently includes banks with minimum Fitch ratings of F1+, AA-, A/B, 2.</p>
<p>Blue (UK nationalised and part-nationalised banks) Up to £20m per banking group for duration up to 1 year. Part-nationalised banks with minimum Fitch ratings of F1+, AA-, D/E, 1.</p>
<p>Orange Up to 20% per counterparty for duration up to 1 year. Subject to maximum of £20m per counterparty group. Currently includes banks with minimum Fitch ratings of F1+, AA-, B/C, 1.</p>

Red

Up to 15% per counterparty group for duration up to 6 months. Subject to maximum of £15m per counterparty group.

Currently includes banks with minimum Fitch ratings of F1, A+, B/C, 2.

Green

Up to 10% per counterparty for duration up to 3 months. Subject to maximum of £10m per counterparty group.

Currently includes banks with minimum Fitch ratings of F1, A, C/D, 2.

Commonly used deposits in this group as at January 2010 -

Purple Instant access AAA rated money market funds.

Blue NatWest instant access account, HBOS instant access account, HBOS time deposits.

Orange National Australia Bank (owns Clydesdale Bank).

Red Abbey instant access account.

Green Clydesdale instant access account, Nationwide time deposits, Barclays time deposits.

- 4.12 In implementing the strategy the intention would be to spread the deposits with as many counterparties as possible, favouring the highest rated groupings first. The counterparty limit applies to a banking group as one entity.

Prudential indicators and overall affordability of capital programme

- 4.13 The report details the Prudential Indicators that must be determined under the requirements of the CIPFA Prudential Code for Capital Finance in Local Authorities. These requirements came into operation on 1 April 2004 under the provisions of the Local Government Finance Act 2003. Part 1 of the Act allows a local authority to borrow money for any purpose that is within its control for the prudent management of its affairs. There is no longer a statutory limit to long term borrowing to support capital investment but the key elements of the Prudential Code require evidence that proposed plans have been assessed as affordable, prudent and sustainable.
- 4.14 As set out in the budget report, under the Prudential system the Council has the ability to borrow in excess of the amount being supported by Government to fund further capital investment. However, such borrowing must be affordable, sustainable and prudent. The Council must meet the whole of the capital financing costs associated with this level of extra borrowing (referred to as Prudential Borrowing) via either compensating savings or by an increase in the level of Council Tax. A fundamental principle when determining affordability of capital spending is that all borrowing undertaken by the Council is secured on its future revenue income.
- 4.15 In order for Members to be able to make an informed decision on capital spending plans various mandatory indicators and limits (referred to as Prudential Indicators) need to be taken into account and set at the start of each financial year. Council are required to set the prudential indicators prior to the start of the new financial year

and the draft prudential indicators are set out in Annex 3. The draft indicators reflect the current capital programme.

- 4.16 The report also details the key changes to CIPFA's Treasury Management revised Code of Practice as a result of the Icelandic crisis and the credit crunch.

5.0 OPTIONS

5.1 Council may approve or amend;

- The draft Treasury Management Strategy at Appendix A.
- The draft investment strategy at Appendix A.
- The draft Prudential Indicators at Annex 3.
- The Minimum Revenue Provision Policy at Annex 1.

6.0 RESOURCE AND VALUE FOR MONEY IMPLICATIONS

6.1 Resource implications and prospects for the capital budget are set out in the report.

6.2 Treasury management activity is conducted with full regard to value for money, evidenced by its record of savings through loan rescheduling, securing loans at low interest rates below target rates, and successful investment of balances.

7.0 LEGAL IMPLICATIONS

7.1 The Council is required to publish its Treasury Management Strategy and comply with Codes of Practice as set out in the report.

8.0 CONCLUSION

8.1 The proposed Treasury Management Strategy supports the Council's capital programme and can be delivered within available resources.

Diane Wood

Corporate Director – Resources

February 2010

APPENDICES

Appendix A: Treasury Strategy 2010/11

Appendix B: Treasury Management 2009/10: update December 2009

Electoral Division(s): *

Executive Decision

	No*
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Key Decision

	No*
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If a Key Decision, is the proposal published in the current Forward Plan?

		N/A*
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Is the decision exempt from call-in on grounds of urgency?

	No*
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If exempt from call-in, has the agreement of the Chair of the relevant Overview and Scrutiny Committee been sought or obtained?

		N/A*
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Has this matter been considered by Overview and Scrutiny?
If so, give details below.

	No*
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Has an environmental or sustainability impact assessment been undertaken?

		N/A*
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Has an equality impact assessment been undertaken?

		N/A*
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PREVIOUS RELEVANT COUNCIL OR EXECUTIVE DECISIONS

No previous relevant decisions

CONSIDERATION BY OVERVIEW AND SCRUTINY

Not considered by Overview and Scrutiny

BACKGROUND PAPERS

RESPONSIBLE CABINET MEMBER

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Treasury Management Strategy Statement, Minimum Revenue Provision Strategy and Annual Investment Strategy 2010/11

1. Introduction

1.1 The Revised CIPFA Treasury Management Code of Practice 2009

In 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 is a separate annex to this report where the Council is asked to adopt the revised Code and the revised Treasury Management Policy Statement.

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 (financial institutions where the Council is prepared to invest cash balances) and should consider setting country, sector and group limits.
- g) Borrowing in advance of need is only 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, as 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) The 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 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).

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 the Cabinet and the Audit and Assurance Committee will receive monitoring reports to ensure regular review by members. 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.

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 / MRP policy	Full Council	Annually before the start of the year
Treasury Management Strategy / Annual Investment Strategy / MRP policy – mid year report	Cabinet	Mid year
Treasury Management Strategy / Annual Investment Strategy / MRP policy – updates or revisions at other times	Cabinet	
Annual Treasury Outturn Report	Cabinet	Annually by 30 September after the end of the year
Treasury Management Monitoring Reports	Cabinet	
Treasury Management Practices	Cabinet	
Scrutiny of treasury management strategy	Scrutiny/Audit and Assurance Committee	Annually before the start of the year
Scrutiny of treasury management performance	Scrutiny/Audit and Assurance Committee	

1.2 Revised CIPFA Prudential Code

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.

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.

1.3 Revised Investment Guidance

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.

1.4 Treasury Management Strategy for 2010/11

The Local Government Act 2003 (the Act) and supporting regulations require 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.

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) (included as paragraph 9 of this report); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The proposed 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.

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
- the borrowing requirement
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy
- creditworthiness policy
- policy on use of external service providers
- the MRP strategy

1.5 Balanced Budget Requirement

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: -

1. *increases in interest charges caused by increased borrowing to finance additional capital expenditure, and*
2. *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.*

2. Treasury Limits for 2010/11 to 2012/13

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.

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’.

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 can be found in appendix 3 of this report.

3. Current Portfolio Position

The Council’s treasury portfolio position at 31/12/2009 comprised:

Table 1	Principal		Ave. rate
	£m	£m	%
Fixed rate funding	PWLB	270.2	4.61
	Market	<u>25.0</u>	4.70
Gross debt		295.2	4.62
Total investments		93.38	0.61
Net debt		<u>201.82</u>	

4. Borrowing Requirement

The Council’s borrowing requirement is as follows:

Table 2	2008/09	2009/10	2010/11	2011/12	2012/13
	£'000	£'000	£'000	£'000	£'000
	actual	probable	estimate	estimate	estimate
New borrowing	10,000	60,000	70,700	31,800	17,100
Alternative financing arrangements	0	0	0	0	0
Replacement borrowing	0	0	0	10,000	0
Total borrowing requirement	10,000	60,000	70,700	41,800	17,100

5. Prudential and Treasury Indicators for 2010/11 – 2012/13

Prudential and Treasury Indicators (as set out in tables 3, 4 and 5 in appendix 3 to this report) are relevant for the purposes of setting an integrated treasury management strategy.

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 in February 2002 by the full Council and the revised Code will be adopted as part of the February 2010 budget considerations.

6. Prospects for Interest Rates

The Council has appointed Sector Treasury Services as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates. Appendix 2 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)

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

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 annex 4 to this report.

7. Borrowing Strategy

7.1 Borrowing rates

The Sector forecast for the PWLB new borrowing rate is as follows: -

	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Mar-12	Mar-13
Bank rate	0.50%	0.50%	0.75%	1.00%	1.50%	3.50%	4.50%
5yr PWLB rate	3.05%	3.20%	3.30%	3.40%	3.60%	4.60%	4.85%
10yr PWLB rate	4.00%	4.05%	4.15%	4.30%	4.45%	5.00%	5.15%
25yr PWLB rate	4.55%	4.65%	4.70%	4.80%	4.90%	5.20%	5.35%
50yr PWLB rate	4.60%	4.70%	4.75%	4.90%	5.00%	5.30%	5.45%

A more detailed Sector forecast is included in annex 2.

In view of the above forecast the Council's borrowing strategy will be based upon the following information.

- Rates are expected to gradually increase during the year which would indicate that consideration should be given to undertaking new long term borrowing for the start of the year. A suitable trigger point of 4.65% is recommended for considering new fixed rate long term borrowing.
- Variable rate borrowing is expected to be cheaper than long term borrowing and will therefore be attractive throughout the financial year compared to taking long term fixed rate borrowing.
- PWLB rates on loans of less than ten years duration are expected to be substantially lower than longer term PWLB rates offering a range of options for new borrowing which will spread debt maturities away from a concentration in long dated debt.
- There is expected to be little difference between 25 year and 50 year rates so therefore loans in the 25-30 year periods could be seen as being more attractive than 50 year borrowing as the spread between the PWLB new borrowing and early repayment rates is considerably less. This would maximise the potential for debt rescheduling and allow the Council to rebalance its debt maturity profile.

Sensitivity of the forecast – In normal circumstances the main sensitivities of the forecast are likely to be the two scenarios noted below. The Council officers, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

- *if it were felt that there was a significant risk of a sharp fall in long and short term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.*
- *if it were felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.*

7.2 External v internal borrowing

TABLE 6: Comparison of gross and net debt positions at year end	2008/09	2009/10	2010/11	2011/12	2012/13
	actual	probable out-turn	estimate	estimate	estimate
	£'000	£'000	£'000	£'000	£'000
Actual external debt (gross)	257,700	317,700	388,400	420,200	437,400
Cash balances	67,370	50,000	50,000	50,000	50,000
Net debt	190,330	267,700	338,400	370,200	387,400

- The Council currently has a difference between gross debt and net debt (after deducting cash balances) of £93.38m
- The general aim of the treasury management strategy is to reduce the difference between the two debt levels over the next three years in order to reduce the credit risk incurred by holding investments. However, measures taken in the last year have already reduced substantially the level of credit risk so another factor which will be carefully considered is the difference between borrowing rates and investment rates to ensure the Council obtains value for money once an appropriate level of risk management has been attained to ensure the security of its investments.
- Over the next three years, investment rates are expected to be below long term borrowing rates and so value for money considerations would indicate that value could best be obtained by avoiding new external borrowing and by using internal cash balances to finance new capital expenditure or to replace maturing external debt (this is referred to as internal borrowing). This would maximise short term savings. However, short term savings by avoiding new long term external borrowing in 2010/11 will also be weighed against the potential for incurring additional long term extra costs by delaying unavoidable new external borrowing until later years when PWLB long term rates are forecast to be significantly higher.

Against this background caution will be adopted with the 2010/11 treasury operations. The Chief Finance Officer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to the appropriate decision making body at the next available opportunity.

7.3 Policy on borrowing in advance of need

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

In determining whether borrowing will be undertaken in advance of need the Council will;

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered

- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow
- consider the merits and demerits of alternative forms of funding
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.

8. Debt Rescheduling

The introduction of the new PWLB rates structure on 1 November 2007 that introduced a spread between the rates applied to new borrowing and repayment of debt, has meant that PWLB to PWLB debt restructuring is now much less attractive than before that date., albeit that opportunities will continue to be considered.

As short term borrowing rates will be considerably cheaper than longer term rates, there are likely to be significant opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of their short term nature and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio. Any such rescheduling and repayment of debt is likely to cause a flattening of the Council's maturity profile as in recent years there has been a skew towards longer dated PWLB.

The Council will also continue to look at the potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt. The debt will be replaced at opportune times, utilising the expected interest rate volatility over the coming financial years.

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings,
- helping to fulfil the strategy, and
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

There has been much discussion as to whether the size of spread between long term PWLB repayment and new borrowing rates should be revised (downwards) in order to help local authorities currently dissuaded from using investment cash balances to repay long term borrowing and thereby reduce counterparty and interest rate risk exposure. The DMO / PWLB have issued a consultation document with suggested options to revise the methodology used to calculate the early repayment rate. The consultation period ended in January 2010 and the Council will monitor developments in this area and may amend its strategy if significant changes are introduced.

All rescheduling will be reported to Cabinet, at the earliest meeting following its action.

9. Annual Investment Strategy

9.1 Investment Policy

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.

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.

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.

Investment instruments identified for use in the financial year are listed in appendix 5 under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

9.2 Creditworthiness policy

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 Swaps spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries

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.

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

All credit ratings will be monitored through the alerts to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

- 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.

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.

The following tables sets out the current and proposed approach for investments:

Current Council Limits

<p>Group 1 - Deposits up to £15 million or 20% of expected cash balances, whichever is lower, for up to 1 year. Includes UK banks part-owned by govt, and banks with minimum Fitch ratings of F1+, AA-, A/B, 2. Also AAA rated money market funds (instant access).</p>
<p>Group 2 - Deposits up to £7 million or 20% of expected cash balances, whichever is lower, for up to 6 months. Includes banks and building societies with minimum Fitch ratings of F1+, AA-, C, 2.</p>
<p>Group 3 - Deposits up to £2 million for up to 3 months. Includes banks and building societies with minimum Fitch ratings of F1, A, B, 3.</p>

Commonly used deposits as at January 2010 -

Group 1 NatWest instant access account, HBOS instant access account, HBOS time deposits, instant access AAA rated money market funds.

Group 2 Abbey instant access, Clydesdale instant access, Nationwide time deposits, Barclays time deposits.

Group 3 Coventry Building Society time deposits.

Proposed New Limits

Follow the colour groupings for duration advised by Sector

<p>Purple - deposits limited to 20% of expected cash balances per counterparty, for duration of up to 2 years. Subject to over-riding maximum of £20m per counterparty group. Currently includes banks with minimum Fitch ratings of F1+, AA-, A/B, 2.</p>
<p>Blue (UK nationalised and part-nationalised banks) Up to £20m per banking group for duration up to 1 year. Part-nationalised banks with minimum Fitch ratings of F1+, AA-, D/E, 1.</p>
<p>Orange Up to 20% per counterparty for duration up to 1 year. Subject to maximum of £20m per counterparty group. Currently includes banks with minimum Fitch ratings of F1+, AA-, B/C, 1.</p>
<p>Red Up to 15% per counterparty for duration up to 6 months. Subject to maximum of £15m per counterparty group. Currently includes banks with minimum Fitch ratings of F1, A+, B/C, 2.</p>
<p>Green Up to 10% per counterparty for duration up to 3 months. Subject to maximum of £10m per counterparty group. Currently includes banks with minimum Fitch ratings of F1, A, C/D, 2.</p>

Commonly used deposits in this group as at January 2010 -

Purple Instant access AAA rated money market funds.

Blue NatWest instant access account, HBOS instant access account, HBOS time deposits.

Orange National Australia Bank (owns Clydesdale Bank).

Red Abbey instant access account.

Green Clydesdale instant access account, Nationwide time deposits, Barclays time deposits.

In implementing the strategy the intention would be to spread the deposits with as many counterparties as possible, favouring the highest rated groupings first. The counterparty limit applies to a banking group as one entity.

9.3 Country limits

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 6. This list will be added to or deducted from by officers should ratings change in accordance with this policy.

9.4 Investment Strategy

In-house funds

Investments will be made with reference to the core cash balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

The Council has the following investment which span the end of the current financial year

<i>Institution</i>	<i>Amount</i>	<i>Maturity</i>	<i>Rate</i>
HBOS – Bank of Scotland	£5,000,000	17/9/2010	1.015%

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%

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

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.

For 2010/11 Council has budgeted for an investment return of 0.90% on investments placed during the financial year.

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.

9.5 End of year investment report

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

9.6 Policy on the use of external service providers

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

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.

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.

9.7 Scheme of delegation

Please see annex 10.

This is required by the Guidance Notes page 22.

9.8 Role of the section 151 officer

Please see annex 11.

This is required by the Guidance Notes page 22.

9.9 Pension fund cash

This Council will comply with the requirements of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, which were implemented on 1st Jan 2010, and from 1st April 2010 will not pool pension fund cash with its own cash balances for investment purposes. Any investments made by the pension fund directly with this local authority after 1 April 2010 will comply with the requirements of SI 2009 No 393.

ANNEXES

1. MRP strategy
2. Interest rate forecasts
3. Prudential and Treasury indicators
4. Economic background
5. Specified and non specified investments
6. Approved countries for investments
7. Central bank meeting dates and rates
8. Treasury Management Policy Statement
9. Adoption of revised CIPFA Treasury Management Code of Practice 2009
10. Treasury management scheme of delegation
11. The treasury management role of the section 151 officer
12. Analysis of Long Term Borrowing

ANNEX 1

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. 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. Government Guidance

Along with the above duty, the Government issued guidance which came into force on 31st March 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 ceased to have effect after the 2006/07 financial year. Transitional arrangements included within the guidance no longer apply for the MRP charge for 2009/10 onwards. Therefore, options 1 and 2 should only be used for Supported Capital Expenditure (SCE). Authorities are however reminded that the CLG document remains as guidance and authorities may consider alternative individual MRP approaches, as long as they are consistent with the statutory duty to make a prudent revenue provision.

Minimum Revenue Provision Policy Statement 2010/11 (England and Wales)

The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2008/09 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.

The major proportion of the MRP for 2010/11 will relate to the more historic debt liability that will continue to be charged at the rate of 4%, in accordance with *option 1* of the guidance. Certain expenditure reflected within the debt liability at 31st March 2010 will, under delegated powers be subject to MRP under *option 3*,

which will be charged over a period which is reasonably commensurate with the estimated useful life applicable to the nature of expenditure, using the equal annual instalment method. For example, capital expenditure on a new building, or on the refurbishment or enhancement of a building, will be related to the estimated life of that building.

Estimated life periods will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

ANNEX 2 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

	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%	0.75%	1.00%	1.50%	2.25%	2.75%	3.25%	3.50%	3.75%	4.25%	4.25%	4.50%
5yr PWLB rate	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	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	4.55%	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	4.60%	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 – 18.1.10

	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%
5yr PWLB rate	3.15%	2.95%	2.65%	2.45%	2.45%	2.45%	2.45%	2.45%
10yr PWLB rate	4.45%	4.15%	3.65%	3.15%	3.15%	3.15%	3.15%	3.15%
25yr PWLB rate	4.75%	4.65%	4.35%	4.05%	3.95%	3.75%	3.75%	3.75%
50yr PWLB rate	4.65%	4.65%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%

UBS interest rate forecast (for quarter ends) – 30.10.09

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

2. SURVEY OF ECONOMIC FORECASTS

HM Treasury December 2009 – summary of forecasts of 23 City and 12 academic analysts for Q4 2009 and 2010. 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%

Treasury Management Strategy Appendix A Annex 3

DRAFT Prudential Indicators determined under Section 3(1) and (2) of the Local Government Act 2003 and produced in accordance with CIPFA's Prudential Code and adjusted to show the effect of the International Financial Reporting Standards

PRUDENTIAL INDICATOR - Affordability		2008/09	2009/10	2010/11	2011/12	2012/13
		Actual	Annual Forecast	Estimate	Estimate	Estimate
		£ p	£ p	£ p	£ p	£ p
1	Affordable Borrowing Limit - Impact of Capital Investment decisions taken : Agreed prior to February 2010 Cumulative cost to council tax (band D, per annum)	£11.32	£18.64	£24.54	£42.33	£72.06
	<i>Impact of PFI/PPP</i>				£16.16	£45.04
	New schemes Incremental cost to council tax (band D, per annum)			£5.38	£8.04	£10.64
	This indicates the incremental and cumulative impact of the capital investment decisions funded from prudential borrowing proposed for the period 2008/09 to 2012/13 based on a Band D property in line with the proposed Council Tax level.					
2	Estimates of proposed capital expenditure	£m	£m	£m	£m	£m
		91.974	128.400	184.361	155.187	207.883
	<i>Impact of PFI/PPP</i>				32.801	123.130
	The actual capital spend for 2008/09, forecast spend for 2009/10 and estimates of capital expenditure to be agreed by County Council in Feb 2010 for the three forward years to 2012/13, as amended to include the Waste PPP and the highways CNDR					
3	Capital Financing Requirement (as at 31 March)	£m	£m	£m	£m	£m
		342.048	370.866	408.436	455.424	499.141
	<i>Impact of PFI/PPP</i>				31.485	61.711
	The Capital financing requirement indicator is a measure of the Council's underlying need to borrow for a capital purpose taken from the balance sheet.					
4(a)	Ratio of Financing costs to net Revenue Stream	%	%	%	%	%
		3.95	7.10	8.51	9.68	10.81
	<i>Impact of PFI/PPP</i>				0.73	1.31
	This indicator shows the proportion of income received from grant and Council Tax that is spent on paying for the consequences of borrowing to fund capital borrowings.					
5	TREASURY MANAGEMENT PRUDENTIAL INDICATORS - Prudence	Revised	Revised	Proposed	Proposed	Proposed
	Authorised limit for external debt -	£m	£m	£m	£m	£m
	borrowing	433	524	540	596	652
	other long term liabilities	5	5	5	5	5
	TOTAL	438	529	545	601	657
	The Authorised Limit and Operational Boundary are the monitoring tools against which the actual external borrowing of the Council will be managed. They are based on a prudent but not worst case scenario and include an allowance for unusual or unexpected cash flow movements but not catastrophic events. If, in the view of the Section 151 Officer, there is projected breach of the Authorised Limit a report must be submitted considering whether the limit should be raised or the action to be taken to ensure the limit is not breached.					
6	Operational boundary -	£m	£m	£m	£m	£m
	borrowing	423	509	525	581	637
	other long term liabilities see below	5	5	5	5	5
	TOTAL	428	514	530	586	642
	The Council is also requested to approve the Operational Boundaries for External Borrowing for the next three years as shown in the table point 6. This boundary is lower than the Authorised limit because it excludes the impact of unusual or unexpected cash flows.					

7	Fixed Interest Rate Exposure Upper limit for Net Principal sums borrowed / invested	Proposed	Proposed	Proposed	Proposed	Proposed
		100%	100%	100%	100%	100%
8	Variable rate exposure (£m as at 31 March) Upper limit for Net Principal sums borrowed / invested	Proposed	Proposed	Proposed	Proposed	Proposed
		40%	40%	40%	40%	40%

These indicators aim to provide the Council with a balance between the uncertainty of interest rate movements and the achievement of optimum performance. This is achieved by setting the upper limits of exposures to both fixed and variable interest rates.

9	Upper limit for total principal sums invested for over 364 days (per maturity date)	Lower of £20m or 20% of the portfolio at any time to 31 March 2013
The purpose of this indicator is to ensure that the Council has protected itself against the risk of loss arising from the need to seek early redemption of principal sums invested. Only core cash will be invested.		

10	Maturity structure of fixed rate borrowing during 2008/09	Upper Limit %	Lower Limit %	
		under 12 months	40%	0%
		12 months and within 24 months	40%	0%
		24 months and within 5 years	30%	0%
		5 years and within 10 years	40%	0%
		10 years and above	100%	30%
The maturity of borrowing is determined by the earliest date on which the lender can require payment. The indicator is designed to exercise control over the Council having large concentrations of fixed rate debt needing to be replaced at any one time.				

Treasury Management Code of Practice

Under the Prudential Code the Council is obliged to adopt the "CIPFA Code of Practice for Treasury Management in the Public Sector". The Council formally adopted the code in 1993.

Notes

- 1 The Prudential Indicators have been updated to take account of all proposals included in the draft capital programme (Cabinet 2 February 2010).
- 2 The Prudential Indicators have also been updated to take account of the implications arising from the introduction of the International Financial reporting Standards (IFRS) relating to the treatment of the CNDR PFI & Waste PPPs (information received from PWC and KPMG). The impact is shown in italics for the first four indicators. The actual cost of these schemes is currently reflected in the revenue budget.

ANNEX 4 Economic Background: Sector's Analysis

Economic Background

4.1. Introduction

- The credit crunch 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.

4.2 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 2 – UBS strong recovery, Capital Economics – weak recovery.

4.2.1 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 there is a change of Government 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.

4.2.2 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

4.2.3 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

ANNEX 5 Specified and Non-Specified Investments

SPECIFIED INVESTMENTS:

(All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' rating criteria where applicable)

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 creditworthiness. 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.

UK banking system support package. 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

**Banks eligible for support under the UK bail-out package: -

- Abbey
- Barclays
- HBOS
- Lloyds TSB
- HSBC
- Nationwide Building Society
- RBS
- Standard Chartered

Specified investments

	Minimum 'High' Credit Criteria	Use
Debt Management Agency Deposit Facility	Govt Backed	In-house
Term deposits – local authorities	High Level of Security	In-house
Term deposits – banks and building societies	Short Term F1+, Long-term AA- Individual Support 3	In-house and fund managers
Fixed term deposits with variable rate and variable maturities: -		
Callable deposits	Long-term AA- Individual Support 1,2 or equivalent	In-house and fund managers
Certificates of deposits issued by banks and building societies	Long-term AA- Individual Support 1,2 or equivalent	In-house buy and hold and fund managers
UK Government Gilts	Long term AAA	In-house buy and hold and Fund Managers
Bonds issued by multilateral development banks	Long term AAA	In-house on a 'buy-and-hold' basis. Also for use by fund managers
Bonds issued by a financial institution which is guaranteed by the UK government	Long term AAA	In-house on a 'buy-and-hold' basis. Also for use by fund managers
Sovereign bond issues (i.e. other than the UK govt)	AAA	In house on a 'buy and hold basis' and Fund Managers
Treasury Bills	--	Fund Managers

<i>Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): -</i>		
<i>1. Money Market Funds</i>	<i>Short term F1+, Long-term AA- Individual Support 1,2 or equivalent</i>	<i>In-house and fund managers</i>
<i>2. Enhanced cash funds</i>	<i>Short term F1+, Long-term AA- Individual Support 1,2 or equivalent</i>	<i>In-house and fund managers</i>
<i>3. Short term funds</i>	<i>Short term F1+, Long-term AA- Individual Support 1,2 or equivalent</i>	<i>In-house and fund managers</i>

Non-Specified Investments:

A maximum of 25% can be held in aggregate in non-specified investments

1. Maturities of ANY period.

	<i>Minimum Credit Criteria</i>	<i>Use</i>
<i>Term deposits with unrated counterparties : any maturity</i>	<i>Sector advice about credit worthiness</i>	<i>In-house</i>

2. Maturities in excess of 1 year

<i>Term deposits – local authorities</i>	<i>--</i>	<i>In-house</i>
<i>Term deposits – banks</i>	<i>Short-term F1+, Long-term AA-, Support 1,2</i>	<i>In-house</i>
<i>Fixed term deposits with variable rate and variable maturities</i>		
<i>1. Callable deposits</i>	<i>Short-term F1+, Long-term AA-, Support 1,2</i>	<i>In-house and fund managers</i>
<i>Certificates of deposits issued by banks and building societies</i>	<i>Short-term F1+, Long-term AA-, Support 1,2</i>	<i>In house on a 'buy and hold basis' and Fund managers</i>
<i>UK Government Gilts</i>	<i>AAA</i>	<i>In house on a 'buy and hold basis' and Fund Managers</i>
<i>Bonds issued by multilateral development banks</i>	<i>AAA</i>	<i>In-house on a 'buy-and-hold' basis. Also for use by fund managers</i>
<i>Bonds issued by a financial institution which is guaranteed by the UK government</i>	<i>AAA</i>	<i>In-house on a 'buy-and-hold' basis. Also for use by fund managers</i>
<i>Sovereign bond issues (i.e. other than the UK govt)</i>	<i>AAA</i>	<i>In house on a 'buy and hold basis' and Fund Managers</i>

ANNEX 6 Approved countries for investments

AAA

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

AA+

- Australia
- Belgium

ANNEX 7 Central Bank Meeting Dates and Rates

Key treasury management dates during the year are:

- MPC quarterly Inflation Report meetings in February, May, August and November
- Pre-Budget Report which outlines the key fiscal plans – usually in early December
- Budget – usually in March / April which gives the detailed fiscal plans for the immediate future

	UK	UK	UK	US	EU	UK	US	ECB
	MPC	MPC Minutes	Inflation Report	FOMC	ECB	Bank Rate	Fed. Rate	Refi Rate
2008								
Jan	-	-		22		5.50%	3.50%	4.00%
Jan	9-10	23		29-30	10	5.50%	3.00%	4.00%
Feb	6-7	20	13	21 (mins)	7	5.25%	3.00%	4.00%
Mar	5-6	19		18	6	5.25%	2.25%	4.00%
Apr	9-10	23		29-30	10	5.00%	2.00%	4.00%
May	7-8	21	14		8	5.00%	2.00%	4.00%
Jun	4-5	18		24-25	5	5.00%	2.00%	4.00%
Jul	9-10	23			3	5.00%	2.00%	4.25%
Aug	6-7	20	13	5	7	5.00%	2.00%	4.25%
Sep	3-4	17		16	4	5.00%	2.00%	4.25%
Oct	8-9	22		28-29	2	4.50%	1.50%	3.75%
Nov	5-6	19	12		6	3.00%	1.00%	3.25%
Dec	3-4	17		16	4	2.00%	0-0.25%	2.50%
2009								
Jan	7-8	21		27-28 (7 mins)	15	1.50%	0-0.25%	2.00%
Feb	4-5	18	11		5	1.00%	0-0.25%	2.00%
Mar	4-5	18		17	5	0.50%	0-0.25%	1.50%
Apr	8-9	22		28-29	2	0.50%	0-0.25%	1.25%
May	6-7	20	13		7	0.50%	0-0.25%	1.00%
Jun	3-4	17		23-24	4	0.50%	0-0.25%	1.00%
Jul	8-9	22			2	0.50%	0-0.25%	1.00%
Aug	5-6	19	12	11	6	0.50%	0-0.25%	1.00%
Sep	9-10	23		22	3	0.50%	0-0.25%	1.00%
Oct	7-8	21			8	0.50%	0-0.25%	1.00%
Nov	4-5	18	11	3-4	5	0.50%	0-0.25%	1.00%
Dec	9-10	23		15	3	0.50%	0-0.25%	1.00%
2010								
Jan	6-7	20		27	14			
Feb	3-4	17	10		4			
Mar	3-4	17		16	4			
Apr	7-8	21		28	8			
May	5-6	19	12		6			
Jun	9-10	23		23	10			
Jul	7-8	21			8			
Aug	4-5	18	11	10	5			
Sep	8-9	22		21	2			
Oct	6-7	20			7			
Nov	3-4	17	10	3	4			
Dec	8-9	22		14	2			

ANNEX 8 Treasury Management Policy Statement

1. 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”.
2. 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.
3. 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.”

ANNEX 9 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.

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.

The revised Code has also set out various requirements which have been summarised in paragraph 1 of the latest Treasury Management Strategy Statement.

RESOLUTIONS

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.

1. 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.

2. 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.

3. The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and for the execution and administration of treasury management decisions to the Chief Finance Officer, who will act in accordance with the Council's policy statement and TMPs and, CIPFA's Standard of Professional Practice on Treasury Management.

4. The Council nominates Cabinet to be responsible for ensuring the effectiveness of the treasury management strategy and policies. Scrutiny and the Audit and Assurance Committee may review Treasury Management arrangements.

ANNEX 10 Treasury management scheme of delegation

(i) Council

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

(ii) 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.

(iii) Scrutiny and Audit Committee

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

ANNEX 11 The treasury management role of the section 151 officer

The S151 (responsible) officer

- 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.

Annex 12: Long Term Borrowing January 2010 - analysed over interest rate and maturity

