APPENDIX 9

Treasury Management Strategy Statement, Annual Investment Strategy and Minimum Revenue Provision Statement 2010/11 to 2012/13

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APPENDIX 9

1. Background

1.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") requires local authorities to determine the Treasury Management Strategy Statement (TMSS). This statement also incorporates the Annual Investment Strategy. Together, these cover the financing and investment strategy for the forthcoming financial year.

In response to the financial crisis in 2008 and the collapse of the Icelandic banks, CIPFA revised the TM Code and Guidance Notes as well as the Prudential Indicators in late November 2009. Communities and Local Government (CLG) is also in the process of revising and updating the Investment Guidance. The required changes have been incorporated into this Strategy on the assumption that the changed code in Appendix 10 is formally adopted.

1.2 CIPFA has defined Treasury Management as:

"the management of the organisation'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."

1.3 The Council is responsible for its treasury decisions and activity. No treasury management activity is without risk. The successful identification, monitoring and control of risk is an important and integral element of its treasury management activities. The main risks to the Council's treasury activities are:

- Credit and Counterparty Risk (Security of Investments)
- Liquidity Risk (Inadequate cash resources)
- Market or Interest Rate Risk (Fluctuations in interest rate levels)
- Inflation Risk (Exposure to inflation)
- Refinancing Risk (Impact of debt maturing in future years)
- Legal & Regulatory Risk
- Fraud & Corruption

1.4 The strategy also takes into account the impact of the Council's Revenue Budget and Capital Programme on the Balance Sheet position, the current and projected Treasury position (Appendix A), the Prudential Indicators (Appendix B) and the outlook for interest rates (Appendix C).

1.5 The purpose of this Treasury Management Strategy Statement is to approve:

- Treasury Management Strategy for 2010-11 (Borrowing - Section 4, Debt Rescheduling - Section 5, Investments - Section 6)
- Prudential Indicators – Appendix B (NB - PI No. 6 - The Authorised Limit is a statutory limit)
- MRP Statement – Section 8
- Use of Specified and Non-Specified Investments – Appendices D & E

2. Balance Sheet and Treasury Position

2.1 The underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) together with Balances and Reserves are the core drivers of Treasury Management Activity. The estimates, based on the current Revenue Budget and Capital Programmes, are set out below:

	31 Mar 10 Estimate £m	31 Mar 11 Estimate £m	31 Mar 12 Estimate £m	31 Mar 13 Estimate £m
CFR	221.7	249.5	279.0	290.0
Balances & Reserves	32.6	30.9	30.7	30.6
Net Balance Sheet Position	189.1	218.6	248.3	259.4

2.2 The Council's level of debt and investments is linked to these components of the Balance Sheet. The current portfolio position is set out at Appendix A. Market conditions, interest rate expectations and credit risk considerations will influence the Council's strategy in determining the borrowing and investment activity against the underlying Balance Sheet position.

2.3 As the CFR represents the level of borrowing for capital purposes and revenue expenditure cannot be financed from borrowing, net physical external borrowing should not exceed the CFR other than for short term cash flow requirements. It is permissible under the Prudential Code to borrow in advance of need up to the level of the estimated CFR over the term of the Prudential Indicators. Where this takes place the cash will form part of its invested sums until the related capital expenditure is incurred. This being the case net borrowing should not exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years other than in the short term due to cash flow requirements. The draft revisions to the CLG's Investment Guidance recommend that the Strategy should state the authority's policies on investing money borrowed in advance of need.

2.4 The move to International Financial Reporting Standards (IFRS) has implications for the Capital Financing Requirement components of the Balance Sheet. The Council's Private Finance Initiative (PFI) scheme is already included within the Balance Sheet. Operating leases have been reclassified and will result in the related long term assets and liabilities being brought onto the Balance Sheet. The estimates for the CFR and Long Term Liabilities have been adjusted to take into the addition of Operating leases. This will influence the determination of the Council's Affordable Borrowing Limit and Operational Boundary.

2.5 The CLG has recently consulted on proposals to reform the council housing subsidy system. The proposed Self-financing option would require a one-off reallocation of housing debt. The estimates set out in Prudential Indicators 6 and 7 of this strategy allow for any potential debt transfer which may arise in the future. Until such time as the transfer may occur the Operational and Authorised limits applicable will be those excluding the Self-financing allowance.

2.6 The estimate for interest payments in 2010/11 is £6.6 million and for interest receipts is £150k.

3. Outlook for Interest Rates

The economic interest rate outlook provided by the Council's treasury advisor, Arlingclose Ltd, is attached at Appendix C. Financial markets remain reasonably volatile as the structural changes necessary within economies and the banking system evolve. This volatility provides opportunities for active treasury management. The Council will reappraise its strategy from time to time and, if needs be, realign it with evolving market conditions and expectations for future interest rates.

4. Borrowing Requirement and Strategy

4.1 The Council's underlying need to borrow for capital purposes is measured by reference to its Capital Financing Requirement (CFR) – see Appendix B. The CFR represents the cumulative capital expenditure of the local authority that has not been financed. To ensure that this expenditure will ultimately be financed, local authorities are required to make a Minimum Revenue Provision for Debt Redemption (MRP) from within the Revenue budget each year.

4.2 Capital expenditure not financed from internal resources (i.e. Capital Receipts, Capital Grants and Contributions, Revenue or Reserves) will produce an increase in the CFR (the underlying need to borrow). In turn this will produce an increased requirement to charge MRP in the Revenue Account.

4.3 External borrowing may be greater or less than the CFR. However, in accordance with the Prudential Code, the Council will ensure that net external borrowing does not, except in the short term, exceed the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years.

4.4 The cumulative estimate of the maximum long-term borrowing requirement is estimated by comparing the projected CFR with the profile of the current portfolio of external debt and long term liabilities over the same financial horizon, as follows:

	31/03/2010 Estimate £m	31/03/2011 Estimate £m	31/03/2012 Estimate £m	31/03/2013 Estimate £m
Capital Financing Requirement	221.7	249.5	279.0	290.0
Less: Existing Profile of Borrowing and Other Long Term Liabilities	176.5	169.9	166.4	160.0
Cumulative Gross External Borrowing Requirement	**45.2**	**79.6**	**112.6**	**130.0**
Balances & Reserves	32.6	30.9	30.7	30.6
Cumulative Net Borrowing Requirement	**12.6**	**48.7**	**81.9**	**99.4**

4.5 There is a significant difference between the gross external borrowing requirement and the net external borrowing requirement represented by the Council's level of balances and reserves. The Council's current strategy is only to borrow to the level of its net borrowing requirement. The reasons for this are to reduce credit risk, take pressure off the Council's lending list and also to avoid the cost of carry existing in the current interest rate environment. Borrowing in advance of need in line with the net borrowing requirement will only be considered if the long term costs outweigh the short term benefits. Capital expenditure levels, market conditions and interest rate levels will be monitored during the year. This will be done in order to minimise borrowing costs over the medium to longer term. A prudent and pragmatic approach to borrowing will be maintained to minimise borrowing costs without compromising the longer-term stability of the portfolio, consistent with the Council's Prudential Indicators.

4.6 In conjunction with advice from its treasury advisor, Arlingclose Ltd, the Council will keep under review the options it has in borrowing from the PWLB, the market and other sources identified in the Treasury Management Practices Schedules, section 4, up to the available capacity within its CFR and Affordable Borrowing Limit (defined by CIPFA as the Authorised Limit).

4.7 The outlook for borrowing rates:
Short-dated gilt yields are forecast to be lower than medium and long-dated gilt yields during the financial year. Despite additional gilt issuance to fund the UK government's support to the banking industry, short-dated gilts are expected to benefit from expectations of lower interest rates as the economy struggles through a recession. Yields for these maturities will fall as expectations for lower interest rates mount.

4.8 The differential between investment earnings and debt costs, despite long term borrowing rates being around historically low levels, remains acute. This is expected to remain a feature during 2010/11. The so-called "cost of carry" associated with long term borrowing compared to temporary investment returns means that the appetite for new long term borrowing brings with it additional short-term costs.

4.9 Public Works Loans Board (PWLB) variable rates have fallen below 1%. They are expected to remain low as the Bank Rate is maintained at historically low levels to enable the struggling economy emerge from the recession. Against a backdrop of interest rates remaining lower for longer and a continuation of the cost of carry, then a passive borrowing strategy (i.e. borrow long term funds as they are required) may remain appropriate. Equally, variable rate funds (that avoid the cost of carry) or EIP (equal instalments of principal) that mitigate the impact are both active considerations.

4.10 Decisions to borrow at low, variable rates of interest will be taken after considering the absolute level of longer term interest rate equivalents and the extent of variable rate earnings on the Council's investment balances. When longer term rates move below the cost of variable rate borrowing any strategic exposure to variable interest rates will be reviewed and, if appropriate, reduced.

4.11 The PWLB will be the preferred source of borrowing given the transparency and control this facility provides. In addition following a programme of early PWLB debt redemption during 2009/10, the ratio of PWLB to market loans has decreased. To address this reduction any new borrowing should ideally be sourced from the PWLB to improve this ratio.

4.12 The Council has £48m LOBO loans (Lender's Options Borrower's Option) of which £10m will be in their option state in FY 2010-11. In the event that the lender exercises the option to change the rate or terms of the loan, the Council will consider the terms being provided and also repayment of the loan without penalty. The Council may utilise cash resources for repayment or may consider replacing the loan(s) by borrowing from the PWLB.

4.13 The Council will undertake a financial options appraisal process to establish how it has arrived at its 'value for money' judgement, in any event where the lender exercises their option to change the rate or terms of the agreement.

5. Debt Rescheduling

5.1 The Council will continue to maintain a flexible policy for debt rescheduling. Market volatility and the steep yield curve may provide opportunities for rescheduling debt from time to time. The rationale for rescheduling would be one or more of the following:

- Savings in interest costs with minimal risk
- Balancing the volatility profile (i.e. the ratio of fixed to variable rate debt) of the debt portfolio
- Amending the profile of maturing debt to reduce any inherent refinancing risks.

5.2 In September 2009, the PWLB issued a Consultation document, entitled 'PWLB Fixed Rates'. The PWLB is reviewing the frequency of rate setting (currently daily) and could move to a live pricing basis. The deadline for the consultation period was 8 January 2010. The likely outcome of this is a reduction in the extent of the margins between premature repayment and new borrowing rates, particularly for longer maturities.

5.3 Any rescheduling activity will be undertaken within the Council's treasury management policy and strategy. The Council will agree in advance with Arlingclose the strategy and framework within which debt will be repaid / rescheduled if opportunities arise. Thereafter the Council's debt portfolio will be monitored against equivalent interest rates and available refinancing options on a regular basis. As opportunities arise, they will be discussed between Arlingclose and the Council's officers.

5.4 All rescheduling activity will comply with the accounting requirements of the local authority SORP. This will also comply with regulatory requirements of the Capital Finance and Accounting Regulations (SI 2007 No 573 as amended by SI 2008/414).

5.5 Borrowing and debt rescheduling activity will be reported in the monthly treasury management outturn report to Cabinet.

6. Investment Policy and Strategy – Annual Investment Strategy

Background

6.1 Guidance from CLG on Local Government Investments in England requires that an Annual Investment Strategy (AIS) be set.

Investment Policy

6.2 To comply with the CLG's guidance, the Council's general policy objective is to invest its surplus funds prudently. The Council's investment priorities are:

- security of the invested capital;
- liquidity of the invested capital;
- an optimum yield which is commensurate with security and liquidity.

The CLG's Guidance on investments reiterates security and liquidity as the primary objectives of a prudent investment policy. The speculative procedure of borrowing purely in order to invest is unlawful.

6.3 Investments are categorised as 'Specified' or 'Non Specified' investments based on the criteria in the CLG Guidance. Potential instruments for the Council's use within its investment strategy are contained in Appendix D.

6.4 The credit crisis has refocused attention on the treasury management priority of security of capital monies invested. The draft revisions to the CLG's Investment Guidance state that a specified investment is one made with a body or scheme of "high credit quality". The Council will continue to maintain a counterparty list based on these criteria. It will monitor and update the credit standing of the institutions on a regular basis. This assessment will include credit ratings and other alternative assessments of credit strength as outlined in paragraph 6.12. The CLG's Draft revisions to its Guidance on local government investments recommend that the Investment Strategy should set out the procedures for determining the maximum periods for which funds may prudently be committed. Such decisions will be based on an assessment of the authority's Balance Sheet position with the limit being set in Prudential Indicator 12 - Upper Limit for total principal sums invested over 364 days.

6.5 The CLG's Draft revisions to its Guidance on local government investments recommend that the strategy should state the authority's policies on investing money borrowed in advance of spending needs. This statement should identify any measures to minimise such investments, including any limits on:

- amounts borrowed and
- periods between borrowing and expenditure.

The statement should also comment on the management of risks, including the risk of loss of the borrowed capital and the risk associated with interest rate changes.

Limits on the amount borrowed in advance of need are identified in the Cumulative Maximum External Borrowing Requirement for future financial years set out in the table at paragraph 4.4. This also sets the periods between borrowing and expenditure. The management of risks, including the risk of loss of the borrowed capital, are identical for all forms of investment as set out in this strategy. The risk associated with interest rate changes are based on the Interest Rate forecast at Appendix C and the current cost of carry referred to in section 4 above.

6.6 The Council's current level of investments is presented at Appendix A.

Investment Strategy

6.7 The global financial market storm in 2008 and 2009 has forced investors of public money to reappraise the question of risk versus yield. Income from investments is a key support in the Council's budget. The UK Bank Rate has been maintained at 0.5% since March 2009. Short-term money market rates are likely to remain at very low levels, which will have a significant impact on investment income. The Council's strategy must however be geared towards this development whilst adhering to the principal objective of security of invested monies.

6.8 The Director of Finance and Resources, under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on the core investment portfolio will be reported to Cabinet and the Audit Committee twice yearly.

Investments managed in-house:

6.9 The Council's shorter term cash flow investments are made with reference to the outlook for the UK Bank Rate and money market rates.

6.10 In any period of significant stress in the markets, the default position for all investments to be made with the Debt Management Office will be considered.

6.11 Currently the Council has restricted its investment activity to:

- The Debt Management Agency Deposit Facility (The rates of interest from the DMADF are below equivalent money market rates. However, the returns are an acceptable trade-off for the guarantee that the Council's capital is secure)
- AAA rated Money Market Funds with a Constant Net Asset Value (CNAV)
- Deposits with other local authorities
- Business reserve accounts and term deposits. These have been primarily restricted to UK institutions that are rated at least A+ long term, and have access to the UK Government's 2008 Credit Guarantee Scheme (CGS)
- Bonds issued by Multilateral Development Banks

6.12 Conditions in the financial sector have begun to show signs of improvement, albeit with substantial intervention by government authorities. In order to diversify the counterparty list, the use of comparable non-UK Banks for investments is now considered appropriate.

The sovereign states whose banks are to be included are Australia, Canada, Finland, France, Germany, Netherlands, Spain, Switzerland and the US. These countries and the Banks within them (see Appendix D), have been selected after analysis and careful monitoring of:

- Credit Ratings (minimum long-term A+)
- Credit Default Swaps
- GDP; Net Debt as a Percentage of GDP
- Sovereign Support Mechanisms / potential support from a well resourced parent institution
- Share Price

The Council has also taken into account information on corporate developments and market sentiment towards the counterparties. The Council and its treasury advisors, Arlingclose, will continue to analyse and monitor these indicators and credit developments on a regular basis. They will respond as necessary to ensure security of the capital sums invested.

Since we remain in a heightened state of sensitivity to risk, vigilance is imperative. This modest expansion of the counterparty list is an incremental step. In order to meet requirements of the revised CIPFA Treasury Management Code, the Council is focusing on a range of indicators (as stated above), not just credit ratings.

Limits for Specified Investments are set out in Appendix D.

6.13 Non Specified Investments:

To protect against a prolonged period of low interest rates, deposits for one to five years and longer-term secure investments will be actively considered within the limits the Council has set for Non-Specified Investments (see Appendix E). The longer-term investments will be likely to include:

- **Supranational bonds (bonds issued by multilateral development banks):** The joint and individual pan-European government guarantees in place on these bonds provide security of the principal invested. Even at the lower yields likely to be in force, the return on these bonds will provide certainty of income against an outlook of low official interest rates.

- **Deposits / Certificates of Deposit with banks or building societies:**
  Deposits for between one and five years and certificates of deposits may be made following consultation with the treasury adviser. Institutions will need to demonstrate a higher level of credit worthiness.

- **UK government guaranteed bonds and debt instruments issued by banks/building societies**:
  The UK Government's 2008 Credit Guarantee Scheme permits specific UK institutions to issue short-dated bonds with an explicit government guarantee. The bonds are issued at a margin over the underlying gilt and would be a secure longer-term investment option.

6.14 **Investments which constitute capital expenditure**
Investments meeting the definition of capital expenditure can be financed from capital or revenue resources. They are also subject to the CLG's Guidance on "non-specified investments". Placing of such investments has accounting, financing and budgetary implications. Whilst it is permissible to fund capital investments by increasing the underlying need to borrow, it should be noted that under the CLG's MRP Guidance, MRP should be applied over a 20 year period.

6.15 The Council has determined that it is not currently prudent to make investments which constitute capital expenditure. These would presently need to be sourced from revenue and therefore the requirement for MRP would make the investment not viable.

6.16 All investment activity will comply with the accounting requirements of the local authority SORP.

7. Balanced Budget Requirement

7.1 The Council complies with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget.

8. 2010/11 Minimum Revenue Provision Statement

8.1 The Local Authorities (Capital Finance and Accounting)(England)(Amendment) Regulations 2008 (SI 2008/414) place a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision (MRP) has been issued by the Secretary of State. Local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

8.2 The major proportion of the MRP for several years from 2009/10 onwards will relate to the more historic debt liability. It will continue to be charged at the rate of 4%, using the CFR as the basis of calculation. Certain expenditure reflected within the debt liability at 31st March 2008 will, under delegated powers, be subject to MRP under option 3. It thus will be charged over a period which is reasonably commensurate with the estimated useful life applicable to the nature of expenditure, using a straight line 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.

8.3 Estimated life periods will be determined under delegated powers. Where expenditure is not on the creation of an asset, and is of a type subject to estimated life periods, to which guidance refers, 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. This would be where the recommendations of the guidance would not be appropriate.

8.4 Some types of capital expenditure incurred by the Council are not capable of being related to an individual asset. In these cases asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit 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. It will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

8.5 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 so as 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. This was previously determined under Regulation, and will in future be determined under Guidance.

8.6 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)
- The share of Housing Revenue Account CFR is not subject to a MRP charge

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

The Council are legally obliged to "have regard" to the guidance. This 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. There is an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period. This period should be 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: -

- 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.

- 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.

8.8 Option 1: Regulatory Method
Under the previous MRP regulations, MRP was set at a uniform rate of 4% of the adjusted CFR 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(R) 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:

- equal instalment method – equal annual instalments
- annuity method – annual payments gradually increase during the life of the asset

8.9 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.

9. Reporting on the Treasury Outturn

The Investment Manager will report on treasury management activity and performance as follows:

(a) A monthly treasury management report will be sent to Cabinet providing an overview of activity and also the treasury out-turn position.

(b) Audit Committee will be responsible for the scrutiny of treasury management strategy and practices.

10. Other items

Member Training

CIPFA's revised Code requires all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. Treasury Management is included in the general finance training for members. Discussions are ongoing with Arlingclose, the Council's treasury management advisors, on devising specific training for Audit Committee.

The CLG's draft revisions to its guidance on local government investments recommend that the Investment Strategy should state what process is adopted for reviewing and addressing the needs of the authority's treasury management staff for training in investment management.

The Council adopts a continuous performance and development programme to ensure staff are regularly appraised and any training needs addressed. Treasury staff also attend regular training sessions, seminars and workshops. These ensure their knowledge is up to date and relevant. Details of training received are maintained as part of the performance and development process.

Investment Consultants

The CLG's Draft revisions to its Guidance on local government investments recommend that the Investment Strategy should state:

- Whether and, if so, how the authority uses external contractors offering information, advice or assistance relating to investment and

- How the quality of any such service is controlled.

The Council has a contract in place with Arlingclose Limited to provide a treasury advisory service. A schedule of services has been agreed between both parties. This clearly set out the duties to be carried out as part of the contract. Performance is measured against the schedule of services to ensure the services being provided are in line with the agreement.

Publication

The CLG's Draft revisions to its Guidance on local government investments recommend that the initial strategy and any revised strategy should, when approved, be made available to the public free of charge, in print or online.

APPENDIX 9

The Treasury Management Strategy Statement is available on the Council’s website.

APPENDIX 9

ANNEX A

EXISTING PORTFOLIO PROJECTED FORWARD

	Current Portfolio £m	31 Mar 10 Estimate £m	31 Mar 11 Estimate £m	31 Mar 12 Estimate £m	31 Mar 13 Estimate £m
External Borrowing:					
Fixed Rate – PWLB	109.6	109.6	105.1	103.6	99.1
Fixed Rate – Market	38.0	38.0	39.0	40.0	38.0
Variable Rate – PWLB	0	15.0	13.5	12.0	10.5
Variable Rate – Market	10.0	10.0	9.0	8.0	10.0
Existing long-term liabilities	3.9	3.9	3.3	2.8	2.4
Total External Debt	161.5	176.5	169.9	166.4	160.0
Investments:					
Deposits and monies on call, Money Market Funds & Supranational Bonds	38.0	35.6	40.6	28.0	39.7
Total Investments	38.0	35.6	40.6	28.0	39.7
Net Borrowing Position	123.5	140.9	129.3	138.4	120.3

ANNEX B

PRUDENTIAL INDICATORS 2010/11 TO 2012/13

1 Background:

There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA’s Prudential Code for Capital Finance in Local Authorities (the “CIPFA Prudential Code”) when setting and reviewing their Prudential Indicators. It should be noted that CIPFA undertook a review of the Code in early 2008, and issued a revised Code in November 2009.

2. Net Borrowing and the Capital Financing Requirement:

This is a key indicator of prudence. This is in order to ensure that over the medium term net borrowing will only be for a capital purpose. The local authority should ensure that the net external borrowing does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

The Director of Finance and Resources reports the Council had no difficulty meeting this requirement in 2009/10, nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

3. Estimates of Capital Expenditure:

3.1 This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits. In particular it considers the impact on Council Tax and, in the case of the HRA, housing rent levels.

No. 1	Capital Expenditure	2009/10 Approved £m	2009/10 Estimate £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
	Non-HRA	92.9	69.8	77.1	61.9	36.3
	HRA	12.3	11.5	22.6	14.0	10.5
	Total	**105.2**	**81.3**	**99.7**	**75.9**	**46.8**

3.2 It is planned that capital expenditure will be financed as follows:

Capital Financing	2009/10 Approved £m	2009/10 Estimate £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
Capital receipts	9.2	4.5	9.0	13.7	8.2
Government Grants	33.0	25.0	34.8	11.0	5.8
Major Repairs Allowance	7.6	8.0	8.2	8.2	8.2
Revenue Contribution	4.6	3.1	2.1	2.1	2.1
Other External Funding	15.8	13.1	12.0	4.8	4.0
Supported borrowing	9.2	3.3	2.1	11.7	6.5
Unsupported borrowing	25.8	24.3	31.5	24.4	12.0
Total	**105.2**	**81.3**	**99.7**	**75.9**	**46.8**

4. Ratio of Financing Costs to Net Revenue Stream:

4.1 This is an indicator of affordability. It highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet borrowing costs.

4.2 The ratio is based on costs net of investment income.

No. 2	Ratio of Financing Costs to Net Revenue Stream	2009/10 Approved %	2009/10 Estimate %	2010/11 Estimate %	2011/12 Estimate %	2012/13 Estimate %
	Non-HRA	4.90	4.14	5.11	6.24	7.25
	HRA	4.15	4.39	4.40	4.88	4.82
	Total	**4.72**	**4.20**	**4.95**	**5.94**	**6.71**

5. Capital Financing Requirement:

5.1 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and its financing. It is an aggregation of the amounts shown for Fixed and Intangible assets, the Revaluation Reserve, the Capital Adjustment Account, Government Grants Deferred and any other balances treated as capital expenditure.

No. 3	Capital Financing Requirement	2009/10 Approved £m	2009/10 Estimate £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
	Non-HRA	172.0	157.6	181.2	207.9	218.7
	HRA	64.0	64.1	68.3	71.1	71.3
	Total CFR	**236.0**	**221.7**	**249.5**	**279.0**	**290.0**

5.2 The year–on-year change in the CFR is due to the following

Capital Financing Requirement	2009/10 Approved £m	2009/10 Estimate £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
Balance B/F	207.0	195.3	221.7	249.5	279.0
Capital expenditure financed from borrowing	35.0	30.6	33.6	36.0	18.5
Revenue provision for debt Redemption.	-5.0	-4.2	-5.8	-6.5	-7.5
Balance C/F	**236.0**	**221.7**	**249.5**	**279.0**	**290.0**

6. Actual External Debt:

6.1 This indicator is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

No. 4	Actual External Debt as at 31/03/2009	£m
	Borrowing	198.0
	Other Long-term Liabilities	4.0
	Total	**202.0**

7. Incremental Impact of Capital Investment Decisions:

7.1 This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax and Housing Rent levels. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

No. 5	Incremental Impact of Capital Investment Decisions	2009/10 Approved £	2010/11 Estimate £	2011/12 Estimate £	2012/13 Estimate £
	Increase in Band D Council Tax	17.64	**2.41**	27.75	50.55
	Increase in Average Weekly Housing Rents	-0.03	**0.06**	0.58	0.58

7.2 The increase in Band D Council tax / average weekly rents reflects the increases in the provision for Capital Financing Charges. It should be noted however for 2010/11 there will in fact be no increase in Council tax as capital expenditure will be financed predominantly from internal resources.

8. Authorised Limit and Operational Boundary for External Debt:

8.1 The Council has an integrated treasury management strategy. It manages its treasury position in accordance with its approved strategy and practice. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Council. It will not just arise from capital spending reflected in the CFR.

8.2 The **Authorised Limit** sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities). This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Council's existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.

8.3 The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario. It has sufficient headroom over and above this to allow for unusual cash movements.

8.4 The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

No. 6	Authorised Limit for External Debt	2009/10 Approved £m	2009/10 Actual £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
	Borrowing	293	293	299	318	313
	Other Long-term Liabilities	3	3	3	3	2
	Total	196	**296**	**302**	**321**	**315**
	Council Housing Subsidy self financing	n/a	n/a	70	70	70
	Total	**296**	**296**	**372**	**391**	**385**

8.5 The **Operational Boundary** links directly to the Council's estimates of the CFR and estimates of other cashflow requirements. This indicator is based on the same estimates as the Authorised Limit. These reflect the most likely, prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

8.6 The Director of Finance and Resources has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the next meeting of Council.

No. 7	Operational Boundary for External Debt	2009/10 Approved £m	2009/10 Actual £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
	Borrowing	268	268	269	288	283
	Other Long-term Liabilities	3	3	3	3	2
	Total	**271**	**271**	**272**	**291**	**285**
	Council Housing Subsidy self financing	-	-	70	70	70
	Total	**271**	**271**	**342**	**361**	**355**

9. Adoption of the CIPFA Treasury Management Code:

9.1 This indicator demonstrates that the Council has adopted the principles of best practice.

No. 8	Adoption of the CIPFA Code of Practice in Treasury Management
	The Council approved the adoption of the CIPFA Treasury Management Code at the Council meeting on 25 February 2010.

The Council has incorporated the changes from the revised CIPFA Code of Practice into its treasury activities.

10. Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure:

10.1 These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. This Council calculates these limits on net principal outstanding sums, (i.e. fixed rate debt net of fixed rate investments)

10.2 The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises, which could adversely impact on the revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments

		2009/10 Approved %	2009/10 Actual %	2010/11 Estimate %	2011/12 Estimate %	2012/13 Estimate %
No 9	Upper Limit for Fixed Interest Rate Exposure	100	100	100	100	100
No 10	Upper Limit for Variable Interest Rate Exposure	50	50	50	50	50

10.3 The limits above provide the necessary flexibility within which decisions will be made for drawing down new loans on a fixed or variable rate basis. The decisions will ultimately be determined by expectations of anticipated interest rate movements as set out in the Council's treasury management strategy.

11. Maturity Structure of Fixed Rate borrowing:

11.1 This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates. It is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

11.2 It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

No. 11	Maturity structure of fixed rate borrowing	Lower Limit %	Upper Limit %
	under 12 months	0	25
	12 months and within 24 months	0	25
	24 months and within 5 years	0	50
	5 years and within 10 years	0	75
	10 years and within 20 years	0	75
	20 years and within 30 years	0	75
	30 years and within 40 years	0	75
	40 years and within 50 years	0	75
	50 years and above	0	75

12. Upper Limit for total principal sums invested over 364 days:

12.1 The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested.

No. 12	Upper Limit for total principal sums invested over 364 days	2009/10 Approved £m	2009/10 Actual £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
		50	50	47	27	10

APPENDIX 9

ANNEX C

Arlingclose Economic and Interest Rate Forecast

Jan-10										
	Sep-09	**Mar-10**	**Jun-10**	**Sep-10**	**Dec-10**	**Mar-11**	**Jun-11**	**Sep-11**	**Dec-11**	**Mar-12**
Official Bank Rate										
Upside risk				+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	**0.50**	**0.50**	**0.50**	**0.50**	**1.00**	**1.50**	**2.00**	**2.50**	**3.00**	**3.00**
Downside risk					-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
1-yr LIBID										
Upside risk				+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	**1.25**	**1.25**	**1.25**	**1.50**	**1.75**	**2.25**	**3.00**	**3.50**	**4.00**	**4.00**
Downside risk					-0.25	-0.25	-0.50	-0.50	-0.50	-0.50
5-yr gilt										
Upside risk		+0.25	+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	**2.50**	**2.70**	**2.80**	**2.90**	**3.00**	**3.25**	**3.50**	**3.75**	**4.00**	**4.25**
Downside risk		-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
10-yr gilt										
Upside risk			+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.25
Central case	**3.50**	**3.75**	**3.75**	**4.00**	**4.00**	**4.25**	**4.25**	**4.50**	**4.50**	**4.75**
Downside risk			-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
20-yr gilt										
Upside risk		+0.25	+0.50	+0.50	+0.50	+0.25	+0.25	+0.25	+0.25	+0.25
Central case	**4.00**	**4.25**	**4.50**	**4.75**	**4.75**	**5.00**	**5.00**	**5.00**	**5.00**	**5.00**
Downside risk		-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
50-yr gilt										
Upside risk		+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	**4.25**	**4.25**	**4.50**	**4.50**	**4.50**	**4.75**	**4.75**	**4.75**	**4.75**	**4.75**
Downside risk			-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25

The recovery in growth is likely to be slow and uneven, more “W” than “V” shaped.

The Bank of England will stick to its lower-for-longer stance on policy rates.

Gilt yields will remain volatile; yields have been compressed by Quantitative Easing and will rise once QE tapers off and if government debt remains at record high levels.

The path of the base rate has been downgraded to reflect the fragile state of the recovering economy and the severe fiscal correction that will be coming post General Election that will dampen aggregate demand and cut household cashflow.

Expectations of central bank exit strategies and their timing will increase volatility in sovereign bond yields and equities.

There are significant threats to the forecast from potential downgrades to sovereign ratings and/or political instability.

Underlying Assumptions:

- The Bank of England’s Quantitative Easing (QE) program which injected £200bn to insure against the downside risks to growth and stimulate the economy officially ends 26th January. We estimate that QE has depressed gilt yields by around 70bs (0.7%).

- The Bank forecasts GDP to grow by 4% in 2011 but concedes growth could be impeded by corporate and consumer balance sheet adjustments, restrictions in bank credit and consumers’ cautious spending behaviour. This is an optimistic forecast in our view; evidence of recovery is scant with weak real economic data and rising unemployment. Q4 2009 grew by just 0.1%.

- Looming bank regulation and liquidity and capital requirements will curb bank lending activity. The Bank retains the option to reduce the rate on commercial banks’ deposits to encourage them to lend. But FSA regulations will force banks to buy more Gilts, which could help slow the rise in yields in 2010/11.

- The employment outlook remains uncertain. Pay freezes, short hours, job cuts and a migration toward part time employment will continue into 2010 keeping the headline unemployment number down.

- Inflation is not an immediate worry for the Bank, which forecasts CPI to rise due to higher commodity prices and VAT reverting to 17.5%. Commodity prices and VAT will push inflation over 3% prompting a letter from the Bank’s Governor to the Chancellor in Q1 2010.

- The UK fiscal deficit remains acute. Cuts in public spending and tax increases are now inevitable and more likely to be pushed through in 2010 by a new government with a clear majority, however a hung parliament cannot be ruled out and would be potentially disruptive to financial markets.

- The net supply of gilts will rise to unprecedented levels in 2010. Failure to articulate and deliver on an urgent and credible plan to lower government borrowing to sustainable levels over the medium term will be negative for gilts.

- The Federal Reserve Chairman Bernanke’s diagnosis of a weak U.S. economy and labour market signal that the Fed’s “extended period” of low rates may get even longer. The outlook for the Eurozone is more optimistic but the European Central Bank will only increase rates after a durable upturn in growth.

ANNEX D

Specified and Non Specified Investments

Specified Investments identified for use by the Council

Specified Investments will be those that meet the criteria in the CLG Guidance, i.e. the investment:

- is sterling denominated
- has a maximum maturity of 1 year
- meets the "high" credit criteria as determined by the Council or is made with the UK government or is made with a local authority in England, Wales and Scotland.
- is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate).

"Specified" Investments identified for the Council's use are:

- Deposits in the DMO's Debt Management Account Deposit Facility
- Deposits with UK local authorities
- Deposits with banks and building societies
- *Certificates of deposit with banks and building societies
- *Gilts : (bonds issued by the UK government)
- *Bonds issued by multilateral development banks
- AAA-rated Money Market Funds with a Constant Net Asset Value (Constant NAV)

* Investments in these instruments will be on advice from the Council's treasury advisor.

For credit rated counterparties, the minimum criteria will be the short-term / long-term ratings assigned by various agencies. These agencies may include Moody's Investors Services, Standard & Poor's and Fitch Ratings.

Long-term minimum: A1 (Moody's) or A+ (S&P) or A+ (Fitch)
Short-term minimum: P-1 (Moody's) or A-1 (S&P) or F1 (Fitch).

The Council will also take into account information on corporate developments, market sentiment and financial indicators towards investment counterparties.

The Director of Finance and Resources has delegated powers to amend the counterparty list as required to maintain effective management of the treasury function.

New specified investments will be made within the following limits:

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Instrument	Country	Counterparty	Maximum Limit Value £m	Maximum Limit %
Term Deposits	UK	DMADF, DMO	No limit	No limit
Term Deposits/Call Accounts	UK	Other UK Local Authorities	£35m per Local Authority	No limit
Term Deposits/Call Accounts	UK	Barclays	20	15
Term Deposits/Call Accounts	UK	Clydesdale	20	15
Term Deposits/Call Accounts	UK	HSBC	20	15
Term Deposits/Call Accounts	UK	Lloyds Banking Group (inc Bank of Scotland)	20	15
Term Deposits/Call Accounts	UK	Nationwide	20	15
Term Deposits/Call Accounts	UK	Royal Bank of Scotland	20	15
Term Deposits/Call Accounts	UK	Santander UK	20	15
Term Deposits/Call Accounts	Australia	Australia and NZ Banking Group	15	15
Term Deposits/Call Accounts	Australia	Commonwealth Bank of Australia	15	15
Term Deposits/Call Accounts	Australia	National Australia Bank Ltd	15	15
Term Deposits/Call Accounts	Australia	Westpac Banking Corp	15	15
Term Deposits/Call Accounts	Canada	Bank of Montreal	15	15
Term Deposits/Call Accounts	Canada	Bank of Nova Scotia	15	15
Term Deposits/Call Accounts	Canada	Canadian Imperial Bank of Commerce	15	15
Term Deposits/Call Accounts	Canada	Royal Bank of Canada	15	15
Term Deposits/Call Accounts	Canada	Toronto-Dominion Bank	15	15

Term Deposits/Call Accounts	Finland	Nordea Bank Finland	15	15
Term Deposits/Call Accounts	France	BNP Paribas	15	15
Term Deposits/Call Accounts	France	Calyon (Credit Agricole Group)	15	15
Term Deposits/Call Accounts	France	Credit Agricole SA	15	15
Term Deposits/Call Accounts	Germany	Deutsche Bank AG	15	15
Term Deposits/Call Accounts	Netherlands	Rabobank	15	15
Term Deposits/Call Accounts	Spain	Banco Bilbao Vizcaya Argentaria	15	15
Term Deposits/Call Accounts	Spain	Banco Santander SA	15	15
Term Deposits/Call Accounts	Switzerland	Credit Suisse	15	15
Term Deposits/Call Accounts	US	JP Morgan	15	15
Gilts	UK	DMO	No limit	No Limit
Bonds	EU	European Investment Bank/Council of Europe	50	40
AAA rated Money Market Funds (MMF)	UK/Ireland/ Luxembourg	CNAV MMFs	5	7.5 per institution. Maximum MMF exposure 37.5

The above percentage limits are based on a rolling average balance of 30 days.

In addition to individual institution limits, a group limit of 20% is applicable.

Non UK Banks are restricted to a maximum exposure of 25% per country and a total overseas aggregate exposure (excluding MMF;s) of 40%.

Maturity periods may be amended to less than one year to address any emerging risk concerns.

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ANNEX E

Non-Specified Investments determined for use by the Council

Having considered the rationale and risk associated with Non-Specified Investments, the following have been determined for the Council's use:

	In-house use	Maximum maturity	Max % of portfolio	Capital expenditure?
▪ Deposits with banks and building societies ▪ Certificates of deposit with banks and building societies	✓	5 years	40 in aggregate	No
Gilts and bonds ▪ Gilts ▪ Bonds issued by multilateral development banks ▪ Bonds issued by financial institutions guaranteed by the UK government, e.g. GEFCO ▪ Sterling denominated bonds by non-UK sovereign governments	✓ (on advice from treasury advisor)	6 years	40 in aggregate	No

In determining the period to maturity of an investment, the investment should be regarded as commencing on the date of the commitment of the investment rather than the date on which funds are paid over to the counterparty.

Deposits and certificates of deposit with banks, and building societies, if taken for periods in excess of one year, will have the following minimum credit ratings:

	Long-term	Short-term
Fitch	AA- (AA minus)	F1+
Moody's	Aa3	P-1
S&P	AA- (AA minus)	A-1+

The Council will also take into account information on corporate developments, market sentiment and financial indicators towards investment counterparties.