Appendix 11

Treasury Management Strategy Statement and Investment Strategy 2011/12 to 2013/14

Contents

Appendices

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") and the Prudential Code require local authorities to determine a Treasury Management Strategy Statement (TMSS) and Prudential Indicators on an annual basis. The TMSS also incorporates the Annual Investment Strategy as required under the CLG's Investment Guidance.

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 are integral elements to treasury management activities and include:

- 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 takes into account the impact of the Council's Revenue Budget and Capital Programme on the Balance Sheet position, the Prudential Indicators and the current and projected Treasury position (Appendix A). The outlook for interest rates (Appendix B) has been taken into account in developing this strategy.

1.5. The purpose of this TMSS is to allow Council to approve:

- Treasury Management Strategy for 2011-12 (Borrowing and Debt Rescheduling - Section 3, Investments - Section 4)
- Prudential Indicators – (NB: the Authorised Limit is a statutory limit)
- MRP Statement – Section 7
- Use of Specified and Non-Specified Investments – Appendices C & D

1.6. As per requirements of the Prudential Code, the Council approved the adoption of the CIPFA Treasury Management Code in February 2010. The Council has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices.

1.7. All treasury activity will continue to comply with relevant statute, guidance and accounting standards.

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 of the CFR, based on the current Revenue Budget and Capital Programmes, are:

	2010/11 Estimate £m	**2011/12 Estimate £m**	**2012/13 Estimate £m**	**2013/14 Estimate £m**
General Fund CFR	168.2	183.4	181.5	182.9
HRA CFR	64.1	67.5	68.6	68.6
Total CFR	232.3	250.9	250.1	251.5
Less: Existing Profile of Borrowing and Other Long Term Liabilities	161.6	158.6	152.6	146.6
Cumulative Maximum External Borrowing Requirement	**70.7**	**92.3**	**97.5**	**104.9**
Balances & Reserves*	16.5	15.4	13.4	11.4
Cumulative Net Borrowing Requirement/(Investments)	**54.2**	**76.9**	**84.1**	**93.5**

*In order to demonstrate a prudent net borrowing position the Balances and Reserves figures quoted above relate to core General Fund balances only and do not include those balances (circa £23m) over which the Council has no direct control.

2.2. The Council's level of physical debt and investments are 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. The Council will ensure that net physical external borrowing (i.e. net of investments) will not exceed the CFR other than for short term cash flow requirements.

Estimates of Capital Expenditure:

2.3. It is a requirement of the Prudential Code to ensure that capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax and in the case of the HRA, housing rent levels.

2.4. The estimates for capital expenditure shown in the next table vary from the draft budget presented in Appendix 9 for the purposes of Treasury Management. Figures presented here are an estimate of likely capital cash outflows whereas the capital budget is set on an accruals basis.

Capital Expenditure	2010/11 Approved £m	2010/11 Revised £m	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m
General Fund	77.1	56.5	61.8	59.8	39.3
HRA	22.6	17.6	11.9	5.4	2.2
Total	**99.7**	**74.1**	**73.7**	**65.2**	**41.5**

2.5. Capital expenditure is expected to be financed as follows:

Capital Financing	2010/11 Approved £m	2010/11 Revised £m	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m
Capital Receipts	9.0	3.1	20.9	27.1	10.9
Government Grants	34.8	35.3	24.7	28.2	19.7
Major Repairs Allowance	8.2	8.2	-	-	-
Revenue Contributions	2.1	0.8	1.9	2.6	2.2
Other External Funding	12.0	3.3	3.0	1.3	1.3
Supported Borrowing	2.1	2.9	-	-	-
Unsupported Borrowing	31.5	20.5	23.2	6.0	7.4
Total	**99.7**	**74.1**	**73.7**	**65.2**	**41.5**

Incremental Impact of Capital Investment Decisions:

2.6. As an indicator of affordability the table below 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.

Incremental Impact of Capital Investment Decisions	2010/11 Approved £	2011/12 Estimate £	2012/13 Estimate £	2013/14 Estimate £
Increase in Band D Council Tax	9.71	10.62	18.73	25.15
Increase in Average Weekly Housing Rents	0.21	(0.17)	0.63	1.94

2.7. While the impact of capital investment on Band D Council Tax is as shown above, savings and efficiencies across the Council have offset these increases in financing costs to enable for Council Tax to remain unchanged for 2010/11 and 2011/12.

Reform to the Council Housing Subsidy System

2.8. CLG consulted on proposals to reform the council housing subsidy system in July 2010 and have now published 'Implementing self-financing for council housing' giving further details of draft settlement amounts and the transitional processes in moving from the subsidy system to a self-financing one. This will see the removal of the subsidy system whereby rents are effectively pooled centrally and then redistributed, by offering a one-off reallocation of debt in return for Authorities retaining all rental income. Legislation enacting these reforms will be introduced in the Localism Bill to enable the new system to commence in April 2012. Initial settlements figures indicate that the Council will undertake £172m of Housing debt in return for an annual subsidy payment to central government that currently amounts to £15m per annum and will finance this through internal resources and/or external borrowing. The Council has the option of borrowing from the PWLB or the market and will, in conjunction with treasury advisors, seek a mix of financial instruments that spreads Treasury risks. In a departure from current Treasury practice this portfolio will be entirely ring-fenced to the HRA and hence eliminate any potential liability on the GF through complex statutory recharging methodologies. It is possible approval may be issued to source this funding during 2011/12 and to accommodate this, a contingency amount of £200m, has been included within the Authorised Limit and Operational Boundary below.

2.9. The estimate for interest payments in 2011/12 is £6.7m and for interest receipts is £0.3m. The ratio of financing costs to the Council's net revenue stream is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet borrowing costs. The ratio is based on costs net of investment income.

Ratio of Financing Costs to Net Revenue Stream	**2010/11 Approved %**	**2010/11 Revised %**	**2011/12 Estimate %**	**2012/13 Estimate %**	**2013/14 Estimate %**
General Fund	5.11	3.53	4.25	5.25	6.43
HRA	4.40	3.78	3.51	3.92	5.36
Weighted Average	**4.95**	**3.58**	**4.07**	**4.92**	**6.16**

3. Borrowing and Rescheduling Strategy

3.1. The Council's balance of actual external debt at 31 January 2011 (gross borrowing plus other long term liabilities) is shown in Appendix A. This Prudential Indicator is comparable with the Operational Boundary and Authorised Limit.

3.2. The **Authorised Limit** sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) and is the statutory limit for borrowing determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

Authorised Limit for External Debt	2010/11 Approved £m	2010/11 Revised £m	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m
Borrowing	299	299	289	300	309
Other Long term Liabilities	3	3	3	2	2
Authorised Limit	**302**	**302**	**292**	**302**	**311**
Authorised Limit including Housing Subsidy Reform Funding	**372**	**372**	**492**	**502**	**511**

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

Operational Boundary for External Debt	2010/11 Approved £m	2010/11 Revised £m	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m
Borrowing	269	269	259	270	279
Other Long term Liabilities	3	3	3	2	2
Operational Boundary	**272**	**272**	**262**	**272**	**281**
Operational Boundary including Housing Subsidy Reform Funding	**342**	**342**	**462**	**472**	**481**

3.4. The Director of Finance & Business Services has delegated authority, within the above limits 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. Council will be notified of any use of this delegated authority.

3.5. In conjunction with advice from its treasury advisor, Arlingclose, the Council will keep under review the following borrowing options:

- Public Works Loan Board (PWLB) loans
- Borrowing from other local authorities
- Borrowing from institutions such as the European Investment Bank and directly from Commercial Banks
- Borrowing from the Money Markets
- Local authority stock issues
- Local authority bills
- Structured finance

3.6. Notwithstanding the issuance of Circular 147 on 20 October 2010, following the CSR announcement which increases the cost of new local authority loans from the PWLB to 1% above the cost of the Government gilts, PWLB still remains an attractive source of borrowing, given the transparency and control its facilities continue to provide. The types of PWLB borrowing that are considered appropriate for a low interest rate environment are:

- Variable rate borrowing
- Medium-term Equal Instalments of Principal (EIP) or Annuity Loans
- Long term Maturity loans, where affordable

Capital expenditure levels, market conditions and interest rate levels will be monitored during the year in order to minimise borrowing costs over the medium to longer term and maintain stability. The differential between debt costs and investment earnings, despite long term borrowing rates being at low levels, remains acute and this is expected to remain a feature during 2011/12. The "cost of carry" associated with medium and long term borrowing compared to temporary investment returns means that new fixed rate borrowing could entail additional short term costs. The use of internal resources in lieu of borrowing may again, in 2011/12, be the most cost effective means of financing capital expenditure.

3.7. PWLB variable rates are expected to remain low as the Bank Rate is maintained at historically low levels for an extended period. Exposure to variable interest rates will be kept under regular review. Each time the spread between long term rates and variable rates narrows by 0.50%, Arlingclose will trigger a formal review point with the Council and options will be considered and decisions taken on whether to retain the same exposure or change from variable to fixed rate debt.

3.8. The Council's existing PWLB variable rate loan borrowed prior to 20 October 2010 will be maintained on its initial terms and is not subject to the additional increased margin for new variable rate loans.

3.9. The Council has £48m loans, which are LOBO loans (Lender's Options Borrower's Option) of which £9m of loans will be in their call period in 2011/12. 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. The default response will however be early repayment without penalty.

3.10. 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, reserves, provisions and working capital. 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.

3.11. 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.

Rates and markets are monitored daily by officers to identify opportunities for rescheduling.

3.12. Borrowing and rescheduling activity will be reported monthly to Cabinet.

3.13. The following Prudential Indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. 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. On a net basis, the Council's upper limit for fixed interest rate exposure for 2011/12 is 25% (100% for debt less 75% for investments). The Council's net upper limit for variable interest rate exposure for 2011/12 is minus 50% (50% for debt less 100% for investments). These Prudential Indicators have been calculated in accordance with CIPFA guidance. The Council's existing level of fixed interest rate exposure for debt is 91% and investments 0%. Variable rate exposure for debt is 9% and investments 100% (Investments excluding Icelandic deposits).

For the purposes of this indicator investments over one year in duration are classified as fixed. For 2011/12 separate debt and investment limits have been included to demonstrate individual exposure to each element.

Upper Limits for Interest Rate Exposure	**Estimated Level (or benchmark level at 31/03/10 %**	**2010/11 Approved Net Exposure %**	**2010/11 Revised %**	**2011/12 Estimate %**	**2012/13 Estimate %**	**2013/14 Estimate %**
Upper Limit for Fixed Interest Rate Exposure on Debt	85	100	100	100	100	100
Upper Limit for Fixed Interest Rate Exposure on Investments	0		(75)	(75)	(75)	(75)
Upper Limit for Variable Interest Rate Exposure on Debt	15	50	50	50	50	50
Upper Limit for Variable Interest Rate Exposure on Investments	(100)		(100)	(100)	(100)	(100)

3.14. The Council will also limit and monitor large concentrations of fixed rate debt needing to be replaced. Limits in the following table are intended to control excessive exposures to volatility in interest rates when refinancing maturing debt.

Maturity structure of fixed rate borrowing	Existing level (or Benchmark level) at 31/03/11 %	Lower Limit for 2011/12 %	Upper Limit for 2011/12 %
under 12 months	1.0	0	25
12 months and within 24 months	3.0	0	25
24 months and within 5 years	5.4	0	50
5 years and within 10 years	28.7	0	75
10 years and within 20 years	10.1	0	100
20 years and within 30 years	0.0	0	100
30 years and within 40 years	0.0	0	100
40 years and within 50 years	19.3	0	100
50 years and above	32.5	0	100

4. Investment Policy and Strategy

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

4.2. 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.

4.3. 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 Appendices C and D. The Director of Finance & Business Services, 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 monthly to Cabinet.

4.4. Amendments to the investment strategy for 2011/12 include:
- Addition of AAA-rated Variable Net Asset Value (VNAV) Money Market Funds
- Addition of Collective Investment Schemes (Pooled Funds)
- Addition of Treasury Bills
- Addition of Local Authority Bills
- Addition of term deposits in Sweden - Counterparty - Svenska Handelsbanken
- Addition of National Westminster Bank and Standard Chartered Bank
- Increase the maximum duration for new deposits to 2 years
- Increase in Money Market Fund limits (From £5m/7.5% to £10m/15% and the total aggregate limit from 37.5% to 75%)
- Removal of Santander UK, Banco Santander and BBVA

These amendments have been proposed following a review to the strategy, taking guidance from the Council's treasury advisors Arlingclose into account. The rationale for these changes is explained in detail below.

The generally improving financial environment has led to a greater degree of confidence in a number of additional investment vehicles including VNAV Money Market Funds and Collective Investment Schemes. In addition, the changes under Basel III could mean that all Money Market Funds become VNAV Funds in the future. The addition of VNAV Funds allows flexibility within the strategy and incorporates the potential for the reclassification of the existing Constant Net Asset Value Funds already included within the strategy. Investments will only be placed on advice from Arlingclose and once they have satisfied their qualifying criteria.

Treasury Bills (T Bills) are included as approved investment instruments. T Bills are short dated, high quality notes issued by HM Treasury. They are issued by the Debt Management Office and are an eligible sovereign instrument meaning that they have a AAA-rating. They provide a direct route for investment with the UK government, with enhanced liquidity and yields over DMADF term deposits. With regard to Local Authority Bills (LA Bills), the Council are not aware of any Local Authorities currently issuing short-term debt securities. However, it is possible that with changes to the PWLB lending policy, Local Authorities may choose to issue short-term bills. These bills would offer a more liquid alternative to term deposits with Local Authorities.

Sweden and Svenska Handelsbanken have been monitored throughout 2009/10 and they now feel comfortable with the country and the bank. The credit default swaps, share price and credit ratings of the bank have held up throughout the credit crunch. Sweden is AA-rated and Svenska is AA-/Aa2/AA-. The GDP and net debt to GDP ratios for Sweden are also in line with the other countries in the current list.

With regard to term deposits with UK counterparties, the Council has included NatWest and Standard Chartered Bank as approved counterparties for 2011/12. Standard Chartered Bank was one of the eight UK institutions given automatic access to the UK Government's Credit Guarantee Scheme in October 2008 and is therefore deemed to be systemically important to the UK Banking System. The Bank also meets Hillingdon's minimum long-term and short term credit ratings. The Council has also included NatWest Bank to its list of approved counterparties. The Bank has maintained its credit ratings over the past twelve months, and remains integral to the RBS Group.

Due to improving credit conditions there has been an increase in the deposit duration limit from 1 year to 2 years. The Council wishes to have the opportunity to lock into higher returns, with strong institutions. It will also assist in protecting against a lower for longer interest rate environment.

The nature of money market funds allows investors to participate in a more diverse and high quality portfolio than they would be able to access individually. The increase in money market fund limits follows the Arlingclose recommendation that a 15% limit should be applied to individual funds. The aggregate limit has been increased in line with the individual limit.

The continued economic issues and deteriorating asset quality within Spain have resulted in the notification of a possible sovereign credit downgrade. This in turn has led to additional notifications of possible downgrades to thirty Spanish banks including Banco Santander and BBVA. These concerns have resulted in both banks being removed form the Council's counterparty list. Santander UK is a bank incorporated in the UK. It is however a wholly owned subsidiary of Banco Santander. Due to concerns over the parent the Council has felt it prudent to also to remove the subsidiary.

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

4.6. The Council's in-house investments are made with reference to the outlook for the UK Bank Rate and money market rates.

4.7. In any period of significant stress in the markets, the default position is for investments to be made with the Debt Management Office or UK Treasury Bills. (The rates of interest from the DMADF are below equivalent money market rates, but the returns are an acceptable trade-off for the guarantee that the Council's capital is secure.

4.8. The Council selects countries and the institutions within them for the counterparty list after analysis and careful monitoring of:

- Credit Ratings (minimum long term A+ for counterparties; AA+ for countries)
- Credit Default Swaps (where quoted)
- GDP; Net Debt as a Percentage of GDP
- Sovereign support mechanisms/potential support from a well-resourced parent institution
- Share Prices (where quoted)
- Macro-economic indicators
- Corporate developments, news articles and market sentiment.

These are listed in Appendix C.

4.9. The Council will continue to analyse and monitor these indicators and credit developments on a regular basis and respond as necessary to ensure security of the capital sums invested.

4.10. The UK Bank Rate has been maintained at 0.5% since March 2009, and is anticipated to remain at low levels throughout 2011/12. Short term money market rates are likely to remain at very low levels for an extended period, which will have a significant impact on investment income.

4.11. To protect against a lower for longer prolonged period of low interest rates and to provide certainty of income, 2 year deposits and longer term secure investments will be considered within the limits the Council has set for Non-Specified Investments (see Appendix D). The longer term investments will be likely to include:

- Term Deposits with counterparties rated at least A+ (or equivalent)

- Supranational Bonds (bonds issued by multilateral development banks): 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.

4.12. The Council has placed an upper limit for principal sums invested for over 364 days, as required by the Prudential Code. 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.

Upper Limit for total principal sums invested over 364 days	2010/11 Approved £m	2010/11 Revised £m	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m
	47	47	17	28	35

4.13. Collective Investment Schemes (Pooled Funds): The Council has evaluated the use of Pooled Funds and determined the appropriateness of their use within the investment portfolio. Pooled funds enable the Council to diversify the assets and the underlying risk in the investment portfolio and provide the potential for enhanced returns. Any investment in pooled will be regularly monitored for both performance and to ensure their continued suitability in meeting the Council's investment objectives.

4.14. 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. 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.

4.15. All investment activity will comply with the accounting requirements of the local authority IFRS based Code of Practice.

5. <u>Outlook for Interest Rates</u>

The economic interest rate outlook provided by the Council's treasury advisor, Arlingclose, is attached at Appendix B. The Council also monitors other sources of market information and will reappraise its strategy from time to time and, if required, realign it with evolving market conditions and expectations for future interest rates.

6. <u>Balanced Budget Requirement</u>

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

7. 2011/12 MRP Statement

7.1. 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.

7.2. The major proportion of the MRP for several years from 2011/12 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 2011 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.

7.3. 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.

7.4. 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.

7.5. 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.

7.6. 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

7.7. 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 is 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.

7.8. 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. Instead of a default position of 25 years, can change to match amortisation over life of asset (i.e. 40 years for a leisure facility)

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

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.

8. Monitoring and Reporting on the Treasury Outturn and Prudential Indicators

Treasury activity is monitored and reported to Senior Management on a daily and weekly basis. Monthly updates are provided to Cabinet as part of the budget monitoring process.

The treasury Prudential Indicators are monitored throughout the year and reported monthly to Senior Management. Compliance with limits are reported monthly to Cabinet.

Cabinet are provided with monthly reports on treasury management activity and performance, and also a strategy report every six months.

Audit Committee are responsible for the yearly scrutiny of treasury management practices.

The Treasury Management Strategy Statement (including Prudential Indicators and Annual Investment Strategy) for the forthcoming financial year is submitted to Cabinet and Audit Committee prior to agreement at full Council before the start of the financial year.

9. Other Items

Training
CIPFA's Code of Practice 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.

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.

Council members receive education regarding treasury management as part of their general finance training. Access to additional training is provided where required.

Investment Consultants

The CLG's 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 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.

APPENDIX A

EXISTING PORTFOLIO PROJECTED FORWARD

	31 Jan 11 Current Portfolio £m	31 Mar 11 Estimate £m	31 Mar 12 Estimate £m	31 Mar 13 Estimate £m	31 Mar 14 Estimate £m
External Borrowing:					
Fixed Rate – PWLB	100.9	100.1	98.6	94.1	89.6
Fixed Rate – Market	48.0	38.0	39.0	48.0	43.0
Variable Rate – PWLB	14.3	13.5	12.0	10.5	9.0
Variable Rate – Market	0.0	10.0	9.0	0.00	5.0
Current Borrowing	**163.2**	**161.6**	**158.6**	**152.6**	**146.6**
New Borrowing	-	-	76.9	84.1	93.5
Total Borrowing	**163.2**	**161.6**	**235.5**	**236.7**	**240.1**
Existing long term liabilities	3.3	3.3	2.8	2.4	2.2
Total Gross External Debt	**166.5**	**164.9**	**238.3**	**239.1**	**242.3**
Total Investments	67.7	24.3	45.2	37.3	37.8
Net Borrowing Position	**98.8**	**140.6**	**193.1**	**201.8**	**204.5**

APPENDIX B

Arlingclose's Economic and Interest Rate Forecast

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14
Official Bank Rate													
Upside risk	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**0.50**	**0.50**	**0.75**	**1.00**	**1.25**	**1.50**	**2.00**	**2.50**	**2.75**	**2.75**	**3.00**	**3.00**	**3.00**
Downside risk	-	-	- 0.25	- 0.50	- 0.50	- 0.50	- 0.50	- 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	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**1.65**	**1.90**	**2.15**	**2.40**	**2.50**	**2.50**	**2.75**	**3.00**	**3.25**	**3.50**	**3.50**	**3.50**	**3.50**
Downside risk	- 0.25	- 0.25	- 0.25	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50
5-yr gilt													
Upside risk	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**2.75**	**3.00**	**3.25**	**3.50**	**3.75**	**4.00**	**4.00**	**4.00**	**4.00**	**4.00**	**4.25**	**4.25**	**4.00**
Downside risk	- 0.25	- 0.25	- 0.25	- 0.25	- 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	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**3.90**	**4.00**	**4.10**	**4.25**	**4.50**	**4.75**	**4.75**	**4.75**	**4.75**	**4.75**	**5.00**	**5.00**	**4.75**
Downside risk	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25
20-yr gilt													
Upside risk	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**4.50**	**4.75**	**5.00**	**5.00**	**5.00**	**5.00**	**5.00**	**5.00**	**5.00**	**5.00**	**5.25**	**5.25**	**5.00**
Downside risk	- 0.25	- 0.25	- 0.25	- 0.25	- 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	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**4.25**	**4.50**	**4.75**	**4.75**	**4.75**	**4.75**	**4.50**	**4.50**	**4.50**	**4.50**	**4.75**	**4.75**	**4.50**
Downside risk	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 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.
- The initial reaction to the CSR is positive, but implementation risks remain.
- The path of base rates reflects the fragility of the recovery and the significantly greater fiscal tightening of the emergency budget. With growth and underlying inflation likely to remain subdued, the Bank will stick to its lower for longer stance on policy rates.
- Uncertainty surrounding Eurozone sovereign debt and the risk of contagion will remain a driver of global credit market sentiment.

Underlying assumptions:

- The framework and targets announced in the Comprehensive Spending Review (CSR) to reduce the budget deficit and government debt will be put to the test; meeting the 2010 borrowing target of £149bn will be crucial to the gilt market's confidence in the credibility of the deficit reduction plans.
- Despite Money Supply being weak and growth prospects remaining subdued, the MPC has gravitated towards increasing rates in the new year as global inflation continues to rise along with household inflation.
- Consumer Price Inflation is stubbornly above 3% and is likely to spike above 4% in the first quarter of 2011 as a result of VAT, utilities and rail fares.
- Unemployment remains near a 16 year high, at just over 2.5 Million, and is set to increase as the Public Sector shrinks. Meanwhile employment is growing but this is mainly due to part time work, leaving many with reduced income.

- Recently announced Basel III capital/liquidity rules and extended timescales are positive for banks. Restructuring of UK banks' balance sheets is ongoing and expected to take a long time to complete. This will be a pre-condition for normalisation of credit conditions and bank lending.
- Mortgage repayment, a reduction in net consumer credit and weak consumer confidence are consistent with lower consumption and therefore the outlook for growth.
- The US Federal Reserve downgraded its outlook for US growth; the Fed is concerned enough to signal further QE through asset purchases. Industrial production and growth in the Chinese economy are showing signs of slowing. Both have implications for the global economy.

While this forecast is produced by Arlingclose, Officers monitor other sources of market information which corroborate the outlook and assumptions detailed above.

APPENDIX C

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 quality" as determined by the Council or is made with the UK government or is made with a local authority in England, Wales, Scotland or Northern Ireland or a parish or community council.
- the making of which 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
- Treasury-Bills (T-Bills)
- Local Authority Bills
- AAA-rated Money Market Funds with a Constant Net Asset Value (CNAV)
- *AAA-rated Money Market Funds with a Variable Net Asset Value (VNAV)
- *Other Money Market Funds and Collective Investment Schemes– i.e. credit rated funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.

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

For credit rated counterparties, the minimum criteria will be the lowest equivalent short term and long term ratings assigned by Fitch, Moody's and Standard & Poor's (where assigned).

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

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

New specified investments will be made within the following limits:

Instrument	**Country/ Domicile**	**Counterparty**	**Maximum Counterparty Limits %/£m**
Term Deposits	UK	DMADF, DMO	No limit
Term Deposits/Call Accounts	UK	Other UK Local Authorities	£35m per Local Authority / No total limit
Term Deposits/Call Accounts	UK	Counterparties rated at least A+ Long Term and F1 Short Term (or equivalent)	15% / £20m
Term Deposits/Call Accounts	Non-UK	Counterparties rated at least A+ Long Term and F1 Short Term (or equivalent) in select countries with a Sovereign Rating of at least AA+	15% / £15m
Gilts	UK	DMO	No limit
Treasury Bills	UK	DMO	No limit
Local Authority Bills	UK	Other UK Local Authorities	No limit
Bonds issued by multilateral development banks		(For example, European Investment Bank/Council of Europe, Inter American Development Bank)	40% / £50m
AAA-rated Money Market Funds	UK/Ireland/ Luxembourg domiciled	CNAV MMFs VNAV MMFs (where there is greater than 12 month history of a consistent £1 Net Asset Value)	15% / £10m per fund. Maximum MMF exposure 75%
Other Money Market Funds and Collective Investment Schemes	UK/Ireland/ Luxembourg domiciled	Pooled funds which meet the definition of a Collective Investment Scheme (CIS) per SI 2004 No 534 and subsequent amendments	15% / £10m per fund. Maximum MMF exposure 75%

Instrument	Country/ Domicile	Counterparty	Maximum Counterparty / Group Limit £m	Maximum Counterparty / Group Limit %
Term Deposits	UK	DMADF, DMO	No limit	No Limit
Term Deposits	UK	Other UK Local Authorities	£35m per Local Authority	No Limit
Term Deposits /Call Accounts	UK	Lloyds Banking Group	20	15
Term Deposits /Call Accounts	UK	Barclays Bank Plc	20	15
Term Deposits /Call Accounts	UK	Clydesdale Bank (National Australia Bank Group)	20	15
Term Deposits /Call Accounts	UK	HSBC Bank Plc	20	15
Term Deposits /Call Accounts	UK	Nationwide Building Society	20	15
Term Deposits /Call Accounts	UK	RBS Group (Royal Bank of Scotland and Nat West)	20	15
Term Deposits /Call Accounts	UK	Standard Chartered Bank	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 (National Australia Bank Group)	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	Credit Agricole CIB (Credit Agricole Group)	15	15
Term Deposits /Call Accounts	France	Credit Agricole SA (Credit Agricole Group)	15	15
Term Deposits /Call Accounts	France	Société Générale	15	15
Term Deposits /Call Accounts	Germany	Deutsche Bank AG	15	15
Term Deposits /Call Accounts	Netherlands	ING Bank NV	15	15
Term Deposits /Call Accounts	Netherlands	Rabobank	15	15
Term Deposits /Call Accounts	Sweden	Svenska Handelsbanken	15	15
Term Deposits /Call Accounts	Switzerland	Credit Suisse	15	15
Term Deposits /Call Accounts	US	JP Morgan	15	15

Please note this list could change if, for example, a counterparty/country is upgraded, and meets our other creditworthiness tools. Alternatively if a counterparty is downgraded, this list may be shortened.

The above percentage limits are based on a 30 day rolling average investment balance.

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

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

APPENDIX D

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 ▪ CDs with banks and building societies	✓ ✓	5 Years	40 In Aggregate	No
▪ Gilts ▪ Bonds issued by multilateral development banks ▪ Bonds issued by financial institutions guaranteed by the UK government ▪ Sterling denominated bonds by non-UK sovereign governments	✓ (on advice from treasury advisor)	6 Years	40 In Aggregate	No
Money Market Funds and Collective Investment Schemes, which are not credit rated	✓ (on advice from treasury advisor)	5 Years	15 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.