

LONDON BOROUGH OF NEWHAM

CABINET

Is it a key decision?	Yes
Is it in the Forward Plan?	Yes
Date report published	10/02/10
Date of meeting	18/02/10

Subject: Treasury Management Strategy Statement 2010/11

Source: Resources [Finance]

Wards affected: All

Purpose of Report

The report presents the 2010/11 Treasury Management Strategy Statement 2010/11 which incorporates the Annual Investment Strategy inclusive of the Prudential Indicators, the Minimum Revenue Provision (MRP) Strategy 2010/11 and the Treasury Policy Statement.

Recommendations

The Mayor in consultation with Cabinet is asked to recommend the Council to adopt:

1. the Annual Treasury Management Strategy Statement incorporating the Annual Investment Strategy 2010/11
2. the Treasury Management Prudential Indicators
3. the MRP Strategy 2010/11 and
4. the Treasury Policy Statement

Reasons for the Recommendations

The Treasury Management Strategy Statement is a requirement of the Council's reporting procedures and recommended by the CIPFA Code of Practice on Treasury Management. The Council is required to comply with the Code through Regulations issued under the Local Government Act 2003.

Statutory Instrument 2008 no 414 s4 states that a local authority shall determine for the current financial year an amount of MRP that it considers to be prudent.

Consultation

- Executive Advisor for Finance and Asset Management, Councillor Lester Hudson
- Audit Board 16 December 2009
- Butlers; and
- Sector Treasury Services Ltd

NAME OF LEAD OFFICER: John Turnbull
POSITION: Divisional Director for Finance

Originator of report: Stephen Wild
Tel no: +44 (0) 20 3373 3881
E-mail address: Stephen.wild@newham.gov.uk

Local Government (Access to Information) Act 1985

Background papers used in preparing this report:

- CIPFA – Treasury Management in the Public Services – Code of Practice & Guide for Chief Financial Officers
- CIPFA Prudential Code for Local Authority Capital Finance
- Sector Treasury Services Ltd. UK Economic Forecasts
- Butlers Economic Forecasts
- London Borough of Newham – Treasury Management Strategy 2008/09 and Policy Statement
- Treasury Management 2008/09 Update & MRP Policy
- Treasury Management Practices
- Accounting Treatment for Premia and Discounts – Audit Board Report 21/1/09
- Local Government Act 2003
- ODPM Guidance on Local Authority Investments 2004
- CIPFA – Treasury and Investment Management in UK Local Authorities – Guidance Notes for Practitioners on Financial Instruments (Chapter 4 of the 2007 SORP)
- CIPFA Treasury Management In Local Authorities – Icelandic Banks Collapse
- Communities and Local Government Select Committee on Local Government Investments, 11 June 2009; and
- Audit Commission, Risk and Return, English Local Authorities and the Icelandic Banks, March 2009

List of enclosures / Appendices:

- Appendix 1: Interest Rate Forecasts
- Appendix 2: Specified and Non-Specified Investments
- Appendix 3: Prudential Indicators.
- Appendix 4: Minimum Revenue Provision Policy Statement 2010/11
- Appendix 5: Treasury Policy Statement.

Treasury Management Strategy Report

1. Introduction and Background

- 1.1 This is the first year in which the Audit Board was asked to review the draft 2010/11 Treasury Management Strategy Statement (TMSS). The TMSS incorporates the Minimum Revenue Provision (MRP) strategy and the Annual Investment Strategy 2010/11 and the Treasury Policy Statement.
- 1.2 The TMSS reflects the requirements of the revised CIPFA Treasury Management in the Public Services Code of Practice and Cross Sectional Guidance Notes – November 09 (the CIPFA TM Code).
- 1.3 The council is required to have regard to the CIPFA TM Code and CLG Investment Guidance 2004 (the Guidance) by the Local Government Act 2003 (The Act). The Government has reviewed the Guidance following publication of the Audit Commission’s report on Icelandic investments, the CIPFA TM Code and issued a consultation document on changes to the capital finance system it is seeking to implement from 1 April 2010. This report takes into consideration the proposed changes on the reasonable presumption that they will be implemented.
- 1.4 The council has accurately anticipated the changes brought in by the new regulations having already implemented most of them. The key changes brought in by the new Code are set out below along with the response (to be)/ taken by officers is set out in Table 1 below:

Table 1: Changes required by the new Code and Action Taken

Change	Action
Requirement to nominate a responsible body for ensuring effective scrutiny of strategy and policies	Audit Board has already been nominated to undertake this role.
Requirement for a mid-year monitoring report	Already in place.
Includes Treasury Management Prudential Indicators previously contained in the Prudential Code	Covered in this strategy – see Appendix 3
Members’ Training	Already Implemented
Increased emphasis on managing risk	Improved risk management in place and covered in the TMSS. See Para. 3.6
Consider use of country, sector and group limits	Already Implemented.
Documented records of counterparties used	The Divisional Director for Finance maintains a counterparty list in compliance with the investment criteria and established guidelines for making decisions.
Use of all three credit rating agencies and act on ‘rating watch’.	Already Implemented. See Para. 3.6.4
Document use of credit information, other than credit ratings:	Already using Credit Default Swaps and market intelligence and is addressed in the TMSS See Para. 3.6.8.
Benchmarking should consider risk and liquidity as well as return	Proposed benchmarks for security and liquidity will be produced.
Officers are required to explicitly follow policies and procedures;	Increased scrutiny has already been implemented in the wake of the Icelandic banks collapse.
Clear on the use of services provided by Advisers	Officers use an extensive network

	of advice from professional sources. Approach is set out in Para 3.9 of this report.
--	--

- 1.5 Statutory Instrument 2008/414 require full Council to approve the MRP Policy Statement in advance of each financial year.

2. Key Considerations and Sustainability

- 2.1 This report sets out the council's TMSS. This has a direct impact on the council's future medium term budget plan. The current medium term capital Finance budget as per the Budget Strategy is set out in Table 2 below:

Table 2: Medium Term Capital Finance Budget

	2010/11 £'000	2011/12 £'000	2012/13 £'000
Interest payable and MRP	36,481	38,782	38,782
Investment income	-3,060	-3,675	-3,675
Net	33,421	35,107	35,107

- 2.2 It is a statutory requirement under S(33) of the Local Government Finance Act 1992, for the council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions.
- 2.3 It is a statutory duty under S(3) of the Act and supporting regulations, for the council to determine and keep under review how much it can afford to borrow.

3. Service Delivery and Performance Issues

3.1 Current treasury position

- 3.1.1 The council's treasury portfolio position as at 31st January 2010 is detailed in table 3 below:

Table 3: Portfolio Position at 31/01/10

	Principal 31/01/10 £m	Ave Rate %
Fixed Rate Funding - PWLB	612	6.00
- Market/Other	235	4.31
	847	
Variable Rate Funding - PWLB	0	0
- Market/Other	262	3.90
	262	4.18
Other Long term Liabilities	0	
Total Debt	1,109	5.33
Total Investments	-328	2.94
Net Position	781	

3.2 Borrowing requirement

- 3.2.1 The council's estimated borrowing requirement over the medium term is £44m and is detailed in table 4 below:

Table 4: Estimated borrowing requirement 2009/13

	2009/10 £'000	2010/11 £'000	2011/12 £'000	2012/13 £'000
Capital Finance Requirement c/fwd	1,053,979	1,140,096	1,215,205	1,223,371
Closing Debt Position	1,149,857	1,179,573	1,179,397	1,179,397
Borrowing (in advance)/required c/fwd	(95,878)	(39,477)	35,808	43,974

3.2.2 The council's policy with regard to borrowing in advance of need is that it would do so only if there was sufficient need within the capital programme to take advanced funding. This would be done with regard to views of experts on how interest rates are likely to move over the medium term.

3.3 Prospects for Interest Rates

3.3.1 Officers have access to treasury advisers, senior economists of major investment banks, Brokers and Capital Economics when developing a council view on interest rates. **Appendix 1** assembles a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. Table 5 provides the officers' view based on this information.

Table 5: Medium Term Rate Forecast (Averages)

Annual Average %	Bank Rate	Money Rates		PWLB Rates		
		3 month	1 year	5 year	20 year	50 year
2008/09	3.9	5.0	5.3	4.2	4.8	4.5
2009/10	0.5	0.8	1.4	3.2	4.4	4.6
2010/11	1.0	1.5	2.3	4.0	5.0	5.2
2011/12	2.0	2.5	3.3	4.3	5.3	5.3
2012/13	4.5	4.8	5.3	5.3	5.5	5.3

3.3.2 Short term rates are expected to remain on hold until mid 2010 at least. The risk to these forecasts is where low economic growth proves to be more protracted than expected and this keeps rates low for longer. The converse is where the rates suddenly increase over fears of public sector finances and from a potential rebound on inflation and interest rates once the Quantitative Easing programme unwinds.

3.4 Borrowing strategy

3.4.1 The current average rate of debt is 5.33% which is currently lower than the London average and is estimated to continue its downward trend to 5.22% in 2012/13.

3.4.2 The council have forward fixed LOBO loans in the first half of 2009/10 because of capital financing need, to mitigate against the expected increase in rates over the next three years and to secure an excellent long term borrowing position. The council has a well balanced maturity profile with an average duration of 46.87 years. The council currently has approx. £1.179 billion of external debt (includes £55m forward debt) and with the council's capital financing requirement (CFR) set to peak at £1.22 billion in 2013, the council is now virtually fully funded for the next three years. This has helped to stabilise capital financing costs within the budget parameters set in the medium term budget strategy.

3.5 **Debt rescheduling**

3.5.1 Due to the HRA balances and the large concentration of high coupon debt in the portfolio, currently such options of restructuring or repayment do not offer any saving opportunities. However, opportunities may arise through using LOBOs and other market loans in rescheduling exercises and these will be monitored by officers.

3.5.2 All rescheduling will be reported to the Audit Board and Cabinet / Council.

3.6 **Annual investment strategy 2010/11**

3.6.1 The council's investment priorities have always been in the following order:

- the security of capital
- the liquidity of its investments; and
- investment return (yield).

3.6.2 The council will aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The new CIPFA TM Code requires that officers place even more emphasis on security and liquidity considerations when making investments and TM processes have been fine tuned accordingly.

3.6.3 Investment instruments identified for use in the financial year are listed in **appendix 2** under the 'Specified' and 'Non Specified' Investments categories. Counterparty limits will be set within the council's Treasury Management Practices (TMP) – Schedules'.

3.6.4 The council will consider the rating opinion of all three rating agencies Fitch, Moody's and Standard and Poor's, where available, when considering the credit quality of the institutions that is included on the council's lending list. All credit ratings will be monitored on a daily basis. The rating criteria will use the lowest common denominator method when selecting counterparties and applying limits. This means that the application of the council's minimum criteria will apply to the lowest available rating for any institution where practicable.

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

3.6.6 If a body is placed on negative rating watch (i.e. there is a reasonable probability of a rating change in the short term and the likelihood of that change being negative) and it is currently near the floor of the minimum acceptable rating for placing investments with that body, then no further investments will be made with that body.

3.6.7 The following ratings criteria will be applied, therefore investments that either match or exceed these ratings will be considered:

- **Banks # 1** – the council will use banks which have at least the following Fitch, Moody's and Standard and Poor's (S&P) ratings (where rated):
 - i. Short Term – Fitch - F1 and equivalent rating from Moody's and S&P
 - ii. Long Term – Fitch – A and equivalent rating from Moody's and S&P
- **Banks # 2** – In addition, the council will use banks whose ratings fall below the criteria specified above if all of the following conditions are met:
 - i. wholesale deposits in the bank are covered by a government guarantee;
 - ii. the government providing the guarantee is rated “AA-” by all three major rating agencies (Fitch, Moody's and S&P's); and
 - iii. the council's investments with the bank are limited to amounts and maturities within the terms of the stipulated guarantee.
- **Banks # 3** - the organisation is an “Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008”, with the necessary short and long term ratings required in Banks # 1 above.
- **Banks # 4** – The council's own banker, if this falls below the above criteria. While the bank remains outside the above criteria, the council will restrict investments to short term only and the amount and duration of investment will be set by the Divisional Director of Finance (DDOF).
- **Bank Subsidiary and Treasury Operations** – the council will use these where the parent bank has the necessary ratings outlined above. Non-rated subsidiaries will not be used.
- **Building Societies** – the council will use all Societies that meet the criteria specified in the council's TMPS or use Societies which meet the ratings for the banks outlined above.
- **Money Market Funds** – the council will use money market funds whose long term rating is AAA and net asset values have a volatility rating of MR1+ or equivalent and hold membership of the International Money Market Funds Association.
- **UK Government (including gilts and the Debt Management Agency Deposit Fund 'DMADF')**
- **Local Authorities**
- **Supranational institutions**

3.6.8 In addition to the use of credit ratings, the council will be advised of information in movements in Credit Default Swap against the iTraxx and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the council's lending list. Officers will also use other evidence to assess credit worthiness, which may include an institution's share price, bond price, publications and periodicals, external cash managers, banks, officer networks, brokers and information; and knowledge acquired through management of the pension fund, published accounts, press reports or commission outside experts to carry out specific research. The type and extent of the information used will depend

on whether the favoured investment option is non specified, has a low credit rating or is not rated at all.

- 3.6.9 Due care will be taken to consider the country, group and sector exposure of the council's investments. The DDOF, under delegated powers and in consideration of the advice received, will undertake the most appropriate form, duration and amount of investment and have regard to country, group, sector exposure, depending on the prevailing interest rate at the time, taking into account the risks and investment priorities detailed above.
- 3.6.10 The criteria for choosing counterparties set out above provide a sound approach to investment in "normal" market circumstances. Whilst members are asked to approve this base criteria above, under the exceptional market conditions the DDOF will continue to temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval. Further, the DDOF may set Individual/Financial Strength (Fitch/Moody's) and Support (Fitch only) to overlay this base criteria as part of the operational investment strategy. These restrictions will remain in place until the banking system returns to "normal" conditions. Similarly the amounts and durations for investments will be restricted. New CLG guidelines require that a separate bank account is required for pensions' cash. The DDOF will establish a separate treasury arrangements and counterparty list for investment of surplus pensions' cash.
- 3.6.11 Investments will accordingly be made with reference to the core balance, cash flow requirements and the outlook for short and medium term interest rates.
- 3.6.12 Yield – local measures of yield benchmarks are:
- Investments – Internal return over the 7 day LIBID rate, Sector Market rate, and the DMO
- Investments – External Fund Manager – 6 Month LIBID reflecting the fact that there is no liquidity requirement on their portfolio.
- 3.6.13 Expectations on shorter term interest rates, on which investment decisions are based, is of the current 0.5% Bank Rate remaining flat with the possibility of a rise in mid 2010. The council will avoid locking into longer term deals while investment rates are at historically low levels unless attractive rates are available which make longer term deals worthwhile. A revised strategy may be prepared should there be significant changes in the risk assessment of a significant proportion of the council's investments or the forward rate curve for interest rates significantly changes from that expected.
- 3.6.14 In house investment balances are likely to rise to circa £350m by the end of March 2010. Officers will consider forward fixing investments where suitable opportunities present themselves.
- 3.6.15 The Council's claim for the recovery of its two Icelandic banks' deposits (£5m Glitnir and £2m Landsbanki) are going through the Icelandic legal process. The Council lodged claims with the Winding Up Boards (WUB) of both banks. The Landsbanki WUB have accepted that depositors are preferential creditors but this has been

challenged by the unsecured creditors and will be referred to the Icelandic courts to settle. The Glitnir WUB ruled that local authority creditors are not preferential creditors and the matter has been referred to the Icelandic court. If both claims are unsuccessful at obtaining priority status this will significantly reduce the recoverable amount. The Council remains optimistic that both claims will obtain priority status but continues to take a prudent view of the outcome in its financial planning.

3.7 **Prudential indicators for 2010/11 - 2012/13 and revised 2009/10**

3.7.1 Prudential indicators (as set out in **appendix 3** to this report) are relevant for the purposes of setting out an integrated treasury management strategy.

3.8 **Minimum Revenue Provision (the MRP)**

3.8.1 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 and so 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 MRP which was previously determined under Guidance.

3.8.2 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. no.3146, (as amended).

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

3.8.4 The guidance offers four main options under which MRP could be made with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits.

3.8.5 The proposed MRP Policy Statement 2010/11 is set out in **appendix 4** of this report.

3.9 **Investment Consultants**

3.9.1 The council uses two advisers: Butlers (contract ends Feb 27 2010) and Sector Treasury Services (contract ends March 31, 2010). The services used are detailed below:

- **Financial Overview/Strategy:** This includes a complete review of the council's financial position with regard to its strategy and objectives. This includes an

analysis of the council's Balance Sheet and relationship of borrowing to the CFR. Examination of future years' forecasts and the implications for the debt and investment portfolios. This regular review would be the starting point for the formulation of a suitable annual treasury management strategy for the council.

- **Interest Rate and Economic advice:** Daily email alerts on market information, monthly newsletter on market and technical updates.
- **Borrowing advice:** The most appropriate level and type of debt in the council's balance sheet. The timing of new borrowing in the context of future expenditure plans, maturity profile, shape of yield curve and most advantageous sources for funding.
- **Debt restructuring:** Monitor opportunities in the council's debt portfolio and model different savings outcomes taking into account underlying implications from the council's housing subsidy entitlement.
- **Technical Advice:** Advice is available on request on all aspects of Capital finance arising from regulation. The council is kept fully informed of any new or revised legislation or other arrangements which may provide some benefit, and of any associated accounting arrangements. A help line facility is also available to officers to help with immediate queries.
- **Treasury Management Policy and Strategy:** Provide advice on the content of the documents that are sent to Members in accordance with the CIPFA TM code.
- **Investment Policy:** Funds managed internally - advice is provided with respect to the "in-house" management of investments, giving due regard to economic analysis and near and medium-term interest rate forecasts. Suggestions are provided with respect to the investment instruments, periods and amounts of investment. A constant review is provided of the council's investment counterparties devoting particular attention to the ratings assigned to them by the major credit rating agencies. Summaries of credit ratings are supplied and updated where required. The council are advised immediately of any changes to these ratings and the implications of these for its list of investment counterparties. This is now overlaid with Credit Default Swap information.
- **Review meetings:** Regular strategy review meetings are held on a quarterly basis.
- **Training and seminars:** Places at regular seminars and Basics of Treasury Management training days are made available to the council free of charge. Where training is a chargeable item, the council are offered places at preferential rates available to clients.

3.9.2 The consultants are reviewed on a constant basis.

4. Links to Community, Local Area Agreement, Corporate Strategies and any other relevant Plans or Strategies

- 4.1 The Treasury Management Strategy 2010/11 forms part of the 2010/11 Service Plan for Finance which in turn fits in with the Council's Corporate Plan. The achievement of the Sustainable Community Strategy and LAA are dependant on a sound financial standing.

5. Risk Management

- 5.1 A fundamental part of Treasury Management involves the management of interest rate changes and thus financial risk. In addition to this, administration procedures are monitored and audited to ensure they are secure. Internal controls ensure investments are only made with financially sound organisations to minimise the risk of capital loss. The Treasury Management Strategy is regularly reviewed with professional advisors to ensure that changes in market conditions can be responded to promptly.

6. Sustainability Impact Appraisal

6.1 Equalities/Diversity implications

- 6.1.1 The report has no specific impact on Equalities/Diversity other than that the achievement of financial savings that will help to maximise resources available for Council services.

6.2 Protecting Children

- 6.2.1 The report has no specific impact on children in the borough other than that the achievement of financial savings that will help to maximise resources available for Council services.

6.3 Human Rights

- 6.3.1 The report has no specific impact on Human Rights in the borough other than that the achievement of financial savings that will help to maximise resources available for Council services.

6.4 Climate Change implications and the effect on the Carbon footprint

- 6.4.1 Not applicable.

6.5 Crime and Disorder

- 6.5.1 Not applicable

6.6 Economic Impact

- 6.6.1 The proposals in this report do not have a direct economic impact within the borough. Clearly the effective operation of treasury activities should contribute towards the financial standing of the Council and the budget strategy that supports the delivery of objectives generally

7. Comments of the Finance Officer

- 7.1 The recommended Annual Strategy and Policy, including the Treasury Prudential Indicators will provide sufficient flexibility for the Head of Finance to manage the Council's loan debt effectively in 2010/11. The Capital Financing forecast used for the Budget strategy is consistent with the proposals of this report.

8. Comments of the Legal Officer

- 8.1 The Treasury Management Strategy is a requirement of the Council's reporting procedures and both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003. The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 state that a local authority has a duty to make an amount of MRP which it considers to be "prudent". The regulation does not itself define "prudent provision" however; the MRP guidance makes recommendations to authorities on interpretation and determination of MRP provision for the future

9. Consultation

- 9.1 This report was reviewed by the Audit Board 16 December 2009. The Council's treasury management operations involve continuous dialogue and consultation between finance staff, the external investment manager, brokers, other local authorities, external advisers and through participation in benchmarking activities.

10. Conclusions

- 10.1 This report has been produced in accordance with statutory regulations and sets out the treasury management strategy and MRP strategy for 2010/11.

Interest Rate Forecasts

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

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

1. INDIVIDUAL FORECASTS

Capital Economics interest rate forecast – 18.1.10

	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
5yr PWLB rate	3.15%	2.95%	2.65%	2.45%	2.45%	2.45%	2.45%	2.45%
10yr PWLB rate	4.45%	4.15%	3.65%	3.15%	3.15%	3.15%	3.15%	3.15%
25yr PWLB rate	4.75%	4.65%	4.35%	4.05%	3.95%	3.75%	3.75%	3.75%
50yr PWLB rate	4.65%	4.65%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%

UBS interest rate forecast (for quarter ends) – 30.10.09

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

2. SURVEY OF ECONOMIC FORECASTS

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

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

Specified and Non-Specified Investments

SPECIFIED INVESTMENTS:

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

	* Minimum 'High' Credit Criteria	Use
Debt Management Agency Deposit Facility	--	In-house
Term deposits – local authorities	--	In-house and Fund Manager
Term deposits – banks and building societies **	Set out in Paragraph 3.6.7, Banks #1,2,3 & 4.	In-house and Fund Managers

	* Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period
Government guarantee on ALL deposits by high credit rated (sovereign rating) countries*	Sovereign rating AA-	In-house and Fund Managers	70	1 year
UK Government support to the banking sector**	-	In-house and Fund Managers	90	1 year

* e.g. Australia (AA+), Singapore (AAA), Hong Kong (AA)

**Banks supported by the UK Credit Guarantee Scheme (8/10/08): -

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

	Minimum 'High' Credit Criteria	Use
Certificates of deposits issued by banks and building societies covered by UK Government guarantee	As para. 3.6.7; Banks#3	In-house buy and hold and Fund Managers
Certificates of deposits issued by banks and building societies NOT covered by UK Government guarantee	As para 3.6.7; Banks #1	In-house buy and hold and Fund Managers
UK Government Gilts	-	In-house and Fund Managers
Bonds issued by multilateral development banks	Long term AAA	In-house and Fund Managers
Bonds issued by a financial institution which is guaranteed by the UK government	Long term AA+	In-house and for Fund Managers
Sovereign bond issues (i.e. other than the UK govt)	AA+	In-house and Fund Managers
UK Treasury Bills	-	Fund Managers
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): -		
1. Government Liquidity Funds	Long-term AAA volatility rating: MR1+ or Equiv.	In-house and Fund Managers
2. Money Market Funds	Long-term AAA volatility rating: MR1+ or Equiv. Membership of IMMA	In-house and Fund Managers
.3. Enhanced cash funds	Long-term AAA volatility rating: MR1+ or Equiv	In-house and Fund Managers
4. Bond Funds	Long-term AAA volatility rating: MR1+ or Equiv	In-house and Fund Managers
5. Gilt Funds	Long-term AAA volatility rating: MR1+ or Equiv	In-house and Fund Managers

** If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate.

NON-SPECIFIED INVESTMENTS: A maximum of 75% will be held in aggregate in non-specified investment

1. Maturities of ANY period

	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period yrs
Fixed term deposits with variable rate and variable maturities: -				
Structured deposits	As set out in Paragraph 3.6.7, Banks #1,2 & 3	In-house And Fund Managers	25	5
<i>(if using)</i> Term deposits with unrated counterparties : any maturity	TMPs	In-house and Fund Managers	25	3
Commercial paper issuance by UK banks covered by UK Government guarantee	UK Government explicit guarantee	In-house and Fund Managers	10	5
Commercial paper other	Short-term F1, Long-term A, Individual C, Support 3	In-house	10	5
Corporate Bonds issued by UK banks covered by UK Government guarantee : <i>the use of these investments may constitute capital expenditure*</i>	UK Government explicit guarantee	In-house and Fund Managers	10	5
Corporate Bonds other : <i>the use of these investments may constitute capital expenditure *</i>	Short-term F1, Long-term A, Individual C, Support 3	In-house and Fund Managers	10	5
Other debt issuance by UK banks covered by UK Government guarantee	UK Government explicit guarantee	In-house and Fund Managers	10	5
Floating Rate Notes : <i>the use of these investments would constitute capital expenditure unless they are issued by a multi lateral development bank</i>	Long-term A	Fund Managers	10	5
Property fund: <i>the use of these investments may constitute capital expenditure*</i>	--	Fund Managers	30	5

* Currently investments in these instruments would count as capital investment, however CLG consultation on the revised Guidance is suggesting this constraint may be lifted.

2. Maturities in excess of 1 year

	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period yrs
Term deposits – local authorities	--	In-house and Fund Managers	75	5
Term deposits – banks and building societies	Set out in Paragraph 3.6.7, Banks #1,2 & 3	In-house and Fund Managers	70	5
Certificates of deposits issued by banks and building societies	Set out in Paragraph 3.6.7, Banks #1,2 & 3	In house and Fund Managers	10	5
UK Government Gilts	-	In-house and Fund Managers	10	5
Bonds issued by multilateral development banks	AAA	In-house and Fund Managers	10	5
Bonds issued by a financial institution which is guaranteed by the UK government	-	In-house and Fund Managers	20	5
Inverse Floaters	Set out in Paragraph 3.6.7, Banks #1,2 & 3	In-house and Fund Managers	20	5
Collateralised Term Deposit	Local Authority or AAA	In-house	50	5
Sovereign bond issues (i.e. other than the UK govt)	AA+	In-house and Fund Managers	10	5
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)				
1. Bond Funds	Long-term AAA volatility rating MR1+	In-house and Fund Managers	10	5
2. Gilt Funds	* Long-term AAA volatility rating MR1+	In-house and Fund Managers	10	5

Prudential Indicators

1. In accordance with CIPFA TM Code the following prudential indicators are recommended for approval.
2. A certain level of capital expenditure will be grant supported by the Government; anything above this level will be unsupported and will need to be paid for from the council's own resources. The key risks to the plans are that the level of Government support has been estimated and is therefore subject to change. Estimates for other sources of funding, such as capital receipts, may also be subject to change over this timescale.
3. The council is asked to approve the summary capital expenditure projections below. This forms the first Prudential Indicator:

Table 1: Capital Expenditure Projections

	2009/10	2010/11	2011/12	2012/13
	Estimated £m	Estimated £m	Estimated £m	Estimated £m
General Fund	141	152	76	34
HRA	106	65	46	27
TOTAL	247	217	122	61

4. Another Prudential Indicator is the council's CFR. The CFR is simply the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of Council's underlying borrowing need. The capital expenditure above which has not immediately been paid for will increase the CFR

Table 2: Capital Financing Requirement

	2009/10	2010/11	2011/12	2012/13
	Estimated £m	Estimated £m	Estimated £m	Estimated £m
General Fund	400	429	473	465
HRA	654	711	742	758
TOTAL	1054	1140	1215	1223

5. A further two prudential indicators control or anticipate the overall level of borrowing. These are:
6. **The Authorised Limit for External Debt** – This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by full Council. This is the statutory limit determined under section 3 (1) of the Act. It is recommended that the council approves the following authorised limits for its external debt gross of investments for the next three financial years. The council is asked to approve these limits and to delegate authority to the DDOF, within the total

limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities. Any such changes made will be reported to the Council at its next meeting following the change.

7. An allowance is also made for sufficient headroom over and above this to allow for operational management, for example unusual cash movements. Risk analysis and risk management strategies have been taken into account, as have plans for capital expenditure, estimates of the CFR and cash flow requirements for all purposes. The council's actual external debt (principal) at 31 March 2009 was £997m.
8. The council is also asked to approve the following operational boundary for external debt for the same period. The proposed operational boundary for external debt is based on the same estimates as the authorised limit, but reflects the best estimate of the most likely scenarios, with limited additional headroom. The operational boundary represents a key management tool for in year monitoring. Within the operational boundary, figures for borrowing and other long-term liabilities are separately identified. The council has delegated authority to the DDOF, within the total operational boundary for any individual year, to effect movement between the separately agreed figures for borrowing and other long term liabilities, in a similar fashion to the authorised limit. Any such changes will be reported to the Council at its next meeting following the change.

Table 3: The Authorised Limit for External Debt

	2010/11	2011/12	2012/13
	Estimated	Estimated	Estimated
	£m	£m	£m
Borrowing	1,316	1,366	1,380
Other Long Term Liabilities	10	10	10
TOTAL	1,326	1,376	1,390

9. **The Operational Boundary for External Debt** – This indicator is based on the expected maximum external debt during the course of the year; it is not a limit.
10. The council is asked to approve the aforementioned Authorised limit and the Operational Boundary below:

Table 4: Operational Boundary for External Debt

	2010/11	2011/12	2012/13
	Estimated	Estimated	Estimated
	£m	£m	£m
Borrowing	1,220	1,250	1,270
Other Long Term Liabilities	10	10	10
TOTAL	1,230	1,260	1,280

11. The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the overall council's finances. The council is asked to adopt the following indicators.

12. Estimates of the ratio of financing costs to net revenue stream – This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

Table 5: Ratio of Financing Costs to Net Revenue Stream

	2010/11 Estimate	2011/12 Estimate	2012/13 Estimate
	%	%	%
General Fund	11.02	11.74	13.23
HRA	31.31	32.80	34.53

13. The estimates of financing costs include current commitments.
14. The following assumes Council Tax does not increase in 2010/11. The council's borrowing strategy has been set to fund the approved Capital Programme within proposed Council Tax levels. If it was decided to increase the Capital Programme by £1m above planned levels the net impact on Council Tax would be £1.11 higher. The cost of the council's prudential borrowing is built into the Budget Strategy.
15. The first prudential indicator in respect of Treasury Management is the adoption of the CIPFA TM code which was approved by Council in March 2002. The Council will also adopt the revised Code.
16. The council is required to set upper limits for both fixed and variable rate exposures for the forthcoming financial year and for the two following years. Taking account of the structure of the debt and investments portfolio, and the likely movement in interest rates, the following limits are proposed.

Table 6: Upper Limits Fixed and Variable Rate Exposures

	2010/11 £m	2011/12 £m	2012/13 £m
Upper limit of fixed rate exposures	1,149	1,166	1,200
Upper limit of variable rate exposures	350	400	400

17. The council is also required to approve limits in respect of the maturity structure of borrowing. The prudential code requires upper and lower limits of the amount of fixed rate debt maturing in each time period as a percentage of the total fixed rate debt. The proposed limits reflect changes in the yield curve that makes draw down of shorter loans more appealing.

Table 7: Upper and Lower Limits Fixed Rate Debt Maturing in Time Period

	Lower Limit	Upper Limit
	%	%
Under 12 months	0	30
Between 1-2 years	0	30
Between 2-5 years	0	30
Between 5-10 years	0	50
In excess of 10 years	75	100

18. The purpose of the Prudential Indicator in respect of investments is to contain the exposure to a loss in the event that early redemption of an investment is required. The council is required to set a maximum amount to be invested beyond the end of

the financial year (>12 months) for the forthcoming financial year and the following two years.

Table 8: Maximum Amount to be invested beyond End of Financial Year

	2010/11	2011/12	2012/13
	£m	£m	£m
Upper limit of principal sums invested beyond the year end > 364 days	275	200	180

Minimum Revenue Provision Policy Statement 2010/11

The council has implemented the MRP guidance and will assess the MRP for 2010/11 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Act.

The major proportion of the MRP for 2010/11 will relate to the more historic debt liability that will continue to be charged at the rate of 4%, in accordance with option 1 of the Guidance. Certain expenditure reflected within the debt liability at 31st March 2008 will under delegated powers be subject to MRP under option 3 – the Asset Life method. MRP may be chargeable on 'large and novel' projects when assets become operational and the calculation will be based on the asset life method. Option 4 Depreciation will be charged over a period which is reasonably commensurate with the estimated useful life applicable to the nature of expenditure, using the equal annual instalment method.

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

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

Treasury Policy Statement

1. Treasury Management within this Council is undertaken in accordance with the CIPFA Code of Practice for Treasury Management in the Public Services (the Code).
2. The Council has been compliant with the requirements of the Code and has formally adopted the key recommendations as described within Section 4 of the Code.
3. In accordance with the Code, the Council defines treasury management activities as:

“The management of the organisation’s 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.”
4. The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.
5. The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.
6. The Council will create and maintain, as the cornerstone for effective treasury management:
 - a Treasury Management Policy Statement, stating the objectives of its Treasury Management activities
 - suitable Treasury Management Practices (TMP) setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities (copy available for members to inspect); and
 - Treasury Management Prudential Indicators as determined by the requirements of the CIPFA Prudential Code.
 - The content of the policy statement and TMP will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the Code’s key principles.
7. The Council will receive reports on its treasury management policies, practices and activities, including as a minimum, an annual strategy and plan in advance of the year, an annual report after its close and an interim review report.

8. The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to the Mayor, and for the execution and administration of treasury management decisions to the Head of Finance, who will act in accordance with the Council's policy statement and the CIPFA Code of Practice for Treasury Management.
9. The Council nominates Audit Board to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

Glossary of Investment Instruments

Callable Deposits: A deposit with a financial institution at a fixed interest rate, where the borrower has a right to repay the loan only on set dates before the maximum term of the deposit. E.g. 3 year, 6 monthly deposit. It may run for 3 years, but the borrower can repay at 6 monthly intervals.

Certificates of Deposit: A written certificate by a bank or financial institution stating that a fixed amount has been deposited with it for a fixed period of time at a predetermined rate of interest. This instrument can then be readily traded in the market, with the price being dependent on the time left until maturity and prevailing rates. E.g. buy a 6 month CD at a rate of 5.25%. After 2 months, the 4 month rate rises to 5.5%, the CD can be sold (at a lower price than face value), if the 4 month rate falls to 5%, it can be sold at a profit.

Debt Management Agency Deposit Facility: This deposit facility allows short-term deposits to be lodged with the Government. This offers the highest security for the principal sum on short-term placements.

Forward Deals: A deal for borrowing or lending at a stated interest rate over a stated period that begins at some time in the future. These are used by parties wishing to protect themselves against future interest-rate movements. E.g. 6 months, 1 year forward. This is an agreement today to enter in to a 6 month investment in 1 year's time.

Inverse Floater: An investment whose rate changes inverse (opposite) to short term interest rates. With an inverse floater, as interest rates rise, the instrument's rate falls. When short-term interest rates fall, the yield increases. E.g. a 3 year deal priced at 11% less 6 month LIBOR. The starting rate for 6 months may be 5.5%, if LIBOR falls to 5% in 6 months time, the next 6 months of the investment would be at 6%. This type of instrument serves to hedge against the risk of falling rates.

Money Market Funds: A Money Market Fund is a "pool" of different types of investments, managed by a fund manager. The pool of investments will typically include bank deposits, Certificates of Deposit (CDs) amongst other investments. A number of organisations will invest in a particular fund. The interest rate yield on an MMF deposit is not known at the time of the deal. In return for this uncertainty, money can be accessed whenever necessary.

Non-rated Building Societies: Building Societies which do not have a credit rating from a rating agency. As the market is well regulated by the Financial Services Authority and is a major source of retail deposits, it is considered unlikely that a leading society would be allowed to fail because of the knock-on effect to other societies and this market sector in general. The asset size of these organisations is used as a guide in determining credit policy in this area.

REITS: Real Estate Investment Trusts. These are collective investments which pool investors' money. Buying shares in a REIT would allow investment in various types of property which are then leased. A REIT aims to pass on

returns at the same level as investors would see if they owned the properties directly.

Reserve Accounts: A bank account where funds can be transferred into for easy access, paying considerably higher rates than a current account, while still allowing instant access.

Supranational Bonds: These are bonds issued by institutions such as the European Investment Bank (EIB) and the World Bank. The credit quality is at least equal to that of UK government bonds as the credit risk is spread over a range of countries, and they are therefore regarded as the safest bond investments, although less liquid than UK Government Bonds. This lack of liquidity is often compensated for in terms of the potentially higher yields in comparison to UK Government Bonds.

Term Deposit: A deposit with an institution for a fixed period and a rate of interest which applies for the duration of the deposit. This period is typically anything from overnight to 5 years.

UK Government Bonds: UK government bonds (or gilts) are one of the safest bond investments because they are backed by the UK government. A loan to the government with a fixed rate of interest and usually over a specified period of time.

The credit rating agencies (Fitch, Moody's and Standard and Poor's) meet with the financial institutions, review their financial prospects and issue ratings. The Fitch ratings are as follows:

- Long term credit ratings are a benchmark of probability of default. The scales are split between investment and speculative grades are spread from AAA (highest credit quality) to BBB (adequate credit quality).
- Short term credit ratings are a benchmark of the probability of default, but with a 12 month time horizon. The scale spreads from F1 (P1 for Moody's) – the highest credit quality to D, which is default.
- Individual ratings attempt to assess how a bank would be viewed if it were entirely independent and could not rely on external support. The rating looks at soundness of balance sheets and business models. The scale spreads from A, a very strong bank, to F, a bank that has either defaulted or would have defaulted had it not been given support.
- Support ratings indicate whether or not the bank will receive support should this be necessary. The scale spreads from 1, extremely high probability of external support, to 5 where support cannot be relied upon.