COUNCIL – 11TH APRIL 2011

Report of the Cabinet

ITEM 6.2 TREASURY MANAGEMENT STRATEGY STATEMENT, MINIMUM REVENUE PROVISION STRATEGY AND ANNUAL INVESTMENT STRATEGY 2011-2012

Purpose of Report

This report sets out the revised Treasury Management Strategy Statement for consideration by Council as well as the Annual Minimum Revenue Provision strategy and the Annual Investment Strategy.

Recommendations

1. That the Treasury Management Strategy Statement, Minimum Revenue Provision Strategy and Annual Investment Strategy, as shown in Appendix A of the report to Cabinet (Annex), be approved;

2. that the Prudential Indicators set out in Tables 3, 4 and 5 of Appendix 3 of Appendix A of the report to Cabinet (Annex) be approved; and

Reasons

1. To ensure that the Council's governance and management procedures for Treasury Management reflect best practice and comply with the Revised CIPFA Treasury Management in the Public Services Code of Practice, Guidance Notes and Treasury Management Policy Statement.

2. To ensure that funding of capital expenditure be taken within the totality of the Council's financial position and that borrowing and investment would only be carried out with proper regard to the Prudential Code for Capital Finance in Local Authorities.

Background

At its meeting on 17th March 2011, Cabinet considered a report of the Chief Executive, which set out the revised Treasury Management Strategy Statement, as well as the Annual Minimum Revenue Provision strategy and the Annual Investment Strategy. The report is attached as an Annex.

The Cabinet resolved that it be recommended to Council that the Treasury Management Strategy Statement, Minimum Revenue Provision Strategy and Annual Investment Strategy be approved, along with the Prudential Indicators and changes to the Financial Procedure Rules.

The reasons for the Cabinet's recommendation are set out in the Reasons section above.

Background Papers:	None specific to the referral to Council
Officer to Contact:	Darren Tilley, Team Leader - Committee and Mayoral Services (01509) 634781 darren.tilley@charnwood.gov.uk

CABINET **ANNEX**

17 March 2011

Report of the Chief Executive

ITEM 7 **Treasury Management Strategy Statement, Minimum Revenue Provision Strategy and Annual Investment Strategy 2011-12**

Purpose of the Report

This report sets out the revised Treasury Management Strategy Statement for recommendation to Council as well as the Annual Minimum Revenue Provision strategy and the Annual Investment Strategy.

Recommendations

That it be recommended to Council to:

1. Approve the Treasury Management Strategy Statement, Minimum Revenue Provision Strategy and Annual Investment Strategy as shown in Appendix A.
2. Approve the Prudential Indictors set out in Tables 3, 4 and 5 of Appendix 3 of Appendix A.

Reasons

1. To ensure that the Council's governance and management procedures for Treasury Management reflect best practice and comply with the CIPFA Treasury Management in the Public Services Code of Practice, Guidance Notes and Treasury Management Policy Statement.
2. To ensure that funding of capital expenditure is taken within the totality of the Council's financial position and that borrowing and investment is only carried out with proper regard to the Prudential Code for Capital Finance in Local Authorities.

Policy Context

The adoption of these policies, indicators and amendments to the Financial Regulations will help the Council to become a Better Council and aid Financial Stability.

Background

The Treasury Management Strategy Statement, Minimum Revenue Provision Strategy and Annual Investment Strategy must be approved by Council each year. These are all set out in the attached report as Appendix A.

The Treasury Management and Annual Investment Strategy have been prepared in accordance with the revised code and accordingly include:

- the treasury limits in force which will limit the treasury risk and activities of the council,
- the Prudential and Treasury Indicators
- the current treasury position,

- the borrowing requirement,
- prospects for interest rates,
- the borrowing strategy,
- policy on borrowing in advance of need,
- debt rescheduling,
- the investment strategy,
- creditworthiness policy,
- the use of external fund managers and treasury advisers,
- Minimum Revenue Provision (MRP) strategy.

There are no major changes to the strategy. However, it does include provision for the change to the Housing Subsidy system in 2012/13 which is why expected borrowings increase from £4.6m to £80m. A revised strategy will be produced before the next financial year and this will cover that change in more detail.

The strategy also assumes that the council will borrow £2.62m for Decent Homes in 2011/12 but this may be covered by disinvesting current funds.

It should be noted that the Council does not currently require a Minimum Revenue Provision but if one were required in the future then this would become a charge to the General Fund account. This is why any such MRP must be sustainable and manageable within the Council's expected income.

Financial Implications

There are no direct financial implications arising from this report.

Risk Assessment

Risk Identified	Likelihood	Impact	Risk Management Actions Planned
Poor investment decisions due to no strategy in place	Low	High	Approved strategy in accordance with CIPFA guidelines and best practice
Loss of council funds through failure of borrowers	Low	High	Credit ratings and other sources used to minimise risks
Market changes rapidly during year	Medium	Medium	Although strategy in place, important to monitor position and use Treasury Consultants and other sources to provide latest advice.
Failure to take effects of Capital Expenditure, when approved, into the budgetary process.	Low	High	Robust procedures to approve Capital Plan after all effects have been considered and evaluated by officers and members.
Exposure to interest rates moving adversely without notice	Low	Medium	Treasury Consultants engaged to advise of changing interest rate scenarios affecting the Council.

Officer to contact:	John Casey (01509) 634810 John.casey@charnwood.gov.uk
Scrutiny Committees:	Audit Committee and Performance Scrutiny Committee
Background Papers:	Local Government Act 2003 Prudential Code for Capital Finance in Local Authorities CIPFA Code for Treasury Management in the Public Services and Cross –Sectorial Guidance Notes
Key Decision:	Yes

Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Statement

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Charnwood Borough Council
2011/12

1. Introduction

1.1 Background

Treasury management is defined as:

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

1.2 Statutory requirements

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

The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance subsequent to the Act and included as paragraph 9 of this report); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The Department of Communities and Local Government has issued revised investment guidance which came into effect from 1 April 2010. There were no major changes required over and above the changes already required by the revised CIPFA Treasury Management Code of Practice 2009.

1.3 CIPFA requirements

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) was adopted by this Council on 26 April 2010.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Audit Committee.

1.4 Treasury Management Strategy for 2011/12

The suggested strategy for 2011/12 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser, Sector Treasury Services Ltd, ('Sector').

The strategy covers:

- treasury limits in force which will limit the treasury risk and activities of the Council
- Prudential and Treasury Indicators
- the current treasury position
- the borrowing requirement
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy
- creditworthiness policy
- policy on use of external service providers
- the MRP strategy

1.5 Balanced Budget Requirement

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

1. increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
2. any increases in running costs from new capital projects are limited to a level which is affordable within the projected income of the Council for the foreseeable future

2. Treasury Limits for 2011/12 to 2013/14

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

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

Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate financing potentially by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years; details of the Authorised Limit can be found in appendix 3 of this report.

3. Current Portfolio Position

The Council's treasury portfolio position at 24 February 2011 comprised:

Table 1

Borrowing by the Council	**Principal £m**	**Average Interest Rate %**
Market Loan - Variable Rate LOBO	2.0	11.625%
Total	**2.0**	
Investments by the Council		
External Fund Manager	10.0	0.850%
Internal Funds	14.7	1.010%
	24.7	
Net Debt	**-22.7**	

4. Borrowing Requirement

The Council's borrowing requirement is as follows:

Table 2

	2009/10 £'000 Actual	2010/11 £'000 Estimate	2011/12 £'000 Estimate	2012/13 £'000 Estimate	2013/14 £'000 Estimate
New Borrowing	0	0	2,620	77,500	0
Total Borrowing Requirement	**0**	**0**	**2,620**	**77,500**	**0**

The above table includes potential borrowing for Decent Homes and the possible borrowing required from the restructuring of the Housing Subsidy system. The former is included as the council will receive an allowance within the Housing Revenue Subsidy in 2011/12 to cover interest. However, the amount may be internally 'borrowed' through disinvestment rather than through external borrowing and this decision is still to be made as the amount of subsidy was only recently announced. The amount included for 2012/13 of £77.5m is in respect of the abolition of the Housing Subsidy system and is the indicative level of debt that the Council may need to incur. Once again this is a fairly recent development and a full modelling exercise and discussion with treasury advisers has still to take place so this amount is provisional.

5. Prudential and Treasury Indicators for 2011/12 – 2013/14

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

The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management and the revised 2009 version was adopted by the full council on 26 April 2010.

6. Prospects for Interest Rates

The Council has appointed Sector as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates. Appendix 2 draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Sector central view.

Sector Bank Rate forecast for financial year ends (March)

- 2010/ 11 0.50%
- 2011/ 12 1.00%
- 2012/ 13 2.25%
- 2013/ 14 3.25%

There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected. A detailed view of the current economic background is contained within appendix 4 to this report.

7. Borrowing Strategy

7.1 Borrowing rates

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

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Mar-13	Mar-14
Bank rate	0.50%	0.50%	0.75%	1.00%	1.00%	2.25%	3.25%
5yr PWLB rate	3.70%	3.70%	3.70%	3.80%	3.90%	4.30%	4.80%
10yr PWLB rate	4.90%	4.90%	4.90%	4.90%	4.90%	5.20%	5.50%
25yr PWLB rate	5.40%	5.40%	5.40%	5.40%	5.40%	5.50%	5.70%
50yr PWLB rate	5.40%	5.40%	5.40%	5.40%	5.40%	5.50%	5.70%

A more detailed Sector forecast is included in appendix 2.

The Council's borrowing strategy will give consideration to new borrowing in the following order of priority: -

1. The cheapest borrowing will be internal borrowing by running down cash balances and foregoing interest earned at historically low rates. However, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing the short term advantage of internal

borrowing against potential long term costs if the opportunity is missed for taking loans at long term rates which will be higher in future years

2. Temporary borrowing from the money markets or other local authorities
3. PWLB variable rate loans for up to 10 years
4. Short dated borrowing from non PWLB below sources
5. Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintaining an appropriate balance between PWLB and market debt in the debt portfolio.
6. PWLB borrowing for periods under 10 years where rates are expected to be significantly lower than rates for longer periods. This offers a range of options for new borrowing which will spread debt maturities away from a concentration in longer dated debt

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

- if it were felt that there was a significant risk of a sharp fall in long and short term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- if it were felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

7.2 External v. internal borrowing

Table 6: Comparison of gross and net debt positions at year end	2009/10	2010/11	2011/12	2012/13	2013/14
	Actual £'000	Estimate £'000	Estimate £'000	Estimate £'000	Estimate £'000
Actual External Debt (gross)	2,000	2,000	4,620	80,000	80,000
Cash Balances	(19,974)	(19,000)	(19,000)	(19,500)	(19,750)
Net Debt	**(17,974)**	**(17,000)**	**(14,380)**	**60,500**	**60,250**

- The Council currently has a difference between gross debt and net debt (after deducting cash balances), of £17,000k

- The council's current borrowing of £2m is due for repayment in 2024. With a current interest rate of 11.625% it is unlikely that the lender would wish this to be repaid early and we have been advised that this position is likely to continue whilst interest rates remain low. The level of premium that would be required to 'buy out' this loan would not represent value for money for the Council.

- In view of this the council will continue to fund capital expenditure from its own resources, plus external grants etc, whilst interest rates remain low. The anticipated borrowing of £2,620k should be matched by external revenue funding to cover the interest costs.

- The general aim of this treasury management strategy will be to reduce the difference between the two debt levels from 2012/13 in order to reduce borrowing cost where this represents value for money.

- Over the next three years, investment rates are therefore expected to be below long term borrowing rates and so value for money considerations would indicate that value could best be obtained by avoiding new external borrowing and by using internal cash balances to finance new capital expenditure or to replace maturing external debt (this is referred to as internal borrowing). This would maximise short term savings.

7.3 Policy on borrowing in advance of need

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

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

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow
- consider the merits and demerits of alternative forms of funding

- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use
- consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them

8. Debt Rescheduling

Debt rescheduling usually involves the premature repayment of debt and its replacement with debt for a different period, to take advantages of differences in the interest rate yield curve. The repayment and replacement does not necessarily have to have happened simultaneously.

As mentioned in item 7.2 above it is unlikely that the premium charged for redeeming the council's one current borrowing would represent value for money during the forthcoming year.

Any debt rescheduling will be reported to the Audit Committee by the Chief Financial Officer at the earliest meeting following the action.

9. Annual Investment Strategy

9.1 Investment Policy

The Council will have regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are: -

(a) the security of capital and
(b) the liquidity of its investments.

The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investments. The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

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

9.2 Creditworthiness policy

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

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

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

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

- Purple — 2 years
- Blue — 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange — 1 year
- Red — 6 months
- Green — 3 months
- No Colour — not to be used
- Other Local Authorities — 12 months
- Debt Management Office — No limit
- Treasury Bills — No limit

The Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties as Moodys tend to be more aggressive in giving low ratings than the other two agencies. This would therefore be unworkable and leave the Council with few banks on its approved lending list. The Sector creditworthiness service does though, use ratings from all three agencies, but by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

All credit ratings will be monitored weekly and the Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

- if a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

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

9.3 Country limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA+ from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). The list of countries that qualify using this credit criteria as at the date of this report are shown in appendix 6. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

9.4 Investment Strategy

In-house funds: The Council's in-house managed funds are mainly cash-flow derived and investments will accordingly be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

The investment strategy shall be to only invest in those institutions which are included in the counterparty list, and only to lend up to the limit set for each counterparty.

The Council currently has two investments that will definitely span the financial year end, being:

	Amount	Maturity	Rate
Bank of Scotland	£5m	5 Sep 2011	2.05%
Barclays Bank	£4m	9 May 2011	1.00%

Interest rate outlook: Bank Rate has been unchanged at 0.50% since March 2009. Bank Rate is forecast to commence rising in quarter 3 of 2011 and then to rise gently from thereon. Bank Rate forecasts for financial year ends (March) are as follows: -

- 2010/ 11 0.50%
- 2011/ 12 1.00%
- 2012/ 13 2.25%
- 2013/ 14 3.25%

There is downside risk to these forecasts if economic growth is weaker than expected. There is also a risk that the Monetary Policy Committee could decide to start raising Bank Rate in quarter 2 of 2011 if it feels it needs to defend its credibility in containing inflation and the inflation expectations of the public.

The suggested budget for investment returns on investments placed for periods less than three months during each financial year is as follows: -

2010/11	0.50%
2011/12	1.10%
2012/13	2.10%
2013/14	3.30%
2014/15	4.10%
2015/16	4.50%

The suggested budget above for 2011/12 of 1.10% assumes that Bank Rate starts increasing from August 2011. There is downside risk to this forecast i.e. that the start of increases in Bank Rate is delayed even further if economic growth is weaker than expected. There is also upside risk if the MPC decides it needs to start increasing Bank Rate in Q2 2011 in order to maintain its credibility in containing inflationary pressures.

The Council will not invest directly for over 364 days and the 2011/12 Budget assumes a return of 1.22% on in-house investments placed during the financial year. This is slightly higher than Sector's view of 1.10% as some of the council's investments will be for longer than three months.

In a full year the difference would be less than £10k and officers believe that this is an achievable and prudent level.

For its cash flow generated balances, the Council will seek to utilise its business reserve accounts, 15 and 30 day accounts, money market funds and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

9.5 End of year investment report

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

9.6 External fund managers

£10.4m of the Council's funds are externally managed on a discretionary basis by Investec Asset Management Ltd.

The Council's external fund manager will comply with the Annual Investment Strategy. The agreement between the Council and the fund manager additionally stipulates guidelines and duration and other limits in order to contain and control risk. The fund managers view risk as integral to each of their businesses and their extensive risk processes are overseen by a Risk Committee.

The fund manager's view on interest rates and opportunities for gilts/bonds is as follows:

Over the last two years the rally in asset prices has been driven by sound economic growth that has been strong enough to repair balance sheets, but weak enough to allow central banks to keep monetary policy exceptionally loose. We doubt whether these elements can continue to coexist indefinitely and if quantitative easing is successful, it will sow the seeds of its own demise. Indeed, we are likely to see an increasingly greater probability that investors will price in a tightening of monetary policy later this year.

In the developed world, the Federal Reserve is in no hurry to change policy, but the UK's monetary policy committee may not be able to shrug off poor CPI data indefinitely, and rising inflation in Europe is likely to encourage the hawks at the European Central Bank (ECB). We still see plenty of scope for government bond markets to sell-off further on rising interest rate expectations, despite the rise in bond yields that has already occurred post 'Quantitative Easing 2'.

We also expect funding problems in peripheral Europe to continue to dog the markets. Portugal and Spain will both have big refinancing needs in the first half of 2011. The euro-zone's policy response remains one of muddle through, and this should be sufficient to keep the show on the road for now. However, a developed sovereign debt crisis should not be ruled out in the longer term; a point underlined by comments from Japan's Cabinet Secretary who recently said that Japan's fiscal position is "approaching the edge of a cliff". Developed bond markets have moved closer to fair value on unchanged interest rates but stronger data and rising commodity prices are beginning to argue for more of a risk premium in yield curves. Our least favourite market is the UK, given rising inflation expectations, followed by the US, where the Federal Reserve appears to have eased more than necessary.

9.7 Policy on the use of external service providers

The Council uses Sector as its external treasury management advisers.

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

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

9.8 Scheme of delegation

Please see appendix 7.

9.9 Role of the section 151 officer

Please see appendix 8.

Appendices

1. MRP strategy
2. Interest rate forecasts
3. Prudential and Treasury indicators
4. Economic background
5. Specified and non specified investments
6. Approved countries for investments
7. Treasury management scheme of delegation
8. The treasury management role of the section 151 officer

APPENDIX 1

Minimum Revenue Provision Policy Statement 2011/12

1. What is a Minimum Revenue Provision?

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

2. Statutory duty

Statutory Instrument 2008 no. 414 s4 lays down that:

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

There is no requirement to charge MRP where the Capital Financing Requirement (CFR) is nil or negative at the end of the preceding financial year. The share of Housing Revenue Account CFR is not subject to an MRP charge.

3. Government Guidance

Along with the above duty, the Government issued guidance which 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 council year to which the provision will relate.

The Council is legally obliged to "have regard" to the guidance, which is intended to enable a more flexible approach to assessing the amount of annual provision than was required under the previous statutory requirements.

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

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

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

4. Date of implementation

As the Council still has a negative Capital Financing Requirement it is recommended that the Council continues with its current policy for 2011/12, which is:

"The Council currently has an overall negative capital financing requirement and therefore does not have to make an MRP provision. If the council, in the future, funds capital expenditure from borrowing, then a policy will need to be adopted in line with the option set out in government guidance. At that time the most appropriate option would be adopted."

APPENDIX 2 Interest Rate Forecasts

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

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

1. Individual Forecasts

Sector: interest rate forecast – 21.2.11

	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
Bank rate	0.50%	0.50%	0.75%	1.00%	1.00%	1.25%	1.50%	2.00%	2.25%	2.50%	3.00%	3.25%	3.25%
3 month LIBID	0.70%	0.80%	1.00%	1.25%	1.50%	1.75%	2.00%	2.25%	2.50%	3.00%	3.25%	3.50%	3.50%
6 month LIBID	1.00%	1.10%	1.20%	1.50%	1.80%	2.10%	2.40%	2.60%	2.80%	3.20%	3.50%	3.80%	4.00%
12 month LIBID	1.50%	1.60%	1.80%	2.10%	2.40%	2.70%	3.00%	3.10%	3.20%	3.40%	3.70%	4.00%	4.20%
5yr PWLB rate	3.70%	3.70%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.50%	4.60%	4.70%	4.80%
10yr PWLB rate	4.90%	4.90%	4.90%	4.90%	4.90%	5.00%	5.10%	5.20%	5.20%	5.30%	5.40%	5.40%	5.50%
25yr PWLB rate	5.40%	5.40%	5.40%	5.40%	5.40%	5.50%	5.50%	5.50%	5.50%	5.60%	5.60%	5.70%	5.70%
50yr PWLB rate	5.40%	5.40%	5.40%	5.40%	5.40%	5.50%	5.50%	5.50%	5.50%	5.60%	5.60%	5.70%	5.70%

Capital Economics: interest rate forecast – 12.1.11

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.50%	2.00%
5yr PWLB rate	3.20%	3.20%	3.00%	2.75%	2.75%	2.90%	3.00%	3.20%	3.40%	3.60%	3.90%	4.20%
10yr PWLB rate	4.75%	4.75%	4.25%	3.75%	3.75%	3.75%	3.75%	3.75%	3.90%	4.00%	4.30%	4.60%
25yr PWLB rate	5.25%	5.25%	4.85%	4.65%	4.65%	4.65%	4.65%	4.65%	4.75%	4.85%	5.10%	5.30%
50yr PWLB rate	5.30%	5.30%	5.20%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.10%	5.20%	5.30%

UBS: interest rate forecast (for quarter ends) – 6.1.11

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
Bank rate	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%	2.00%
10yr PWLB rate	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%
25yr PWLB rate	5.25%	5.30%	5.35%	5.40%	5.45%	5.50%	5.55%	5.60%
50yr PWLB rate	5.35%	5.40%	5.45%	5.50%	5.55%	5.60%	5.65%	5.70%

2. Survey of Economic Forecasts

HM Treasury February 2011

The current Q4 2011 and Q4 2012 forecasts are based on the February 2011 report. Forecasts for 2011 – 2015 are based on 32 forecasts in the quarterly forecast for February 2011.

BANK RATE FORECASTS		quarter ended		annual average Bank Rate				
	actual	Q4 2011	Q4 2012	ave. 2011	ave. 2012	ave. 2013	ave. 2014	ave. 2015
Median	0.50%	1.00%	2.00%	0.80%	1.50%	2.40%	3.20%	3.70%
Highest	0.50%	2.00%	3.50%	2.10%	2.80%	3.10%	4.30%	5.00%
Lowest	0.50%	0.50%	0.50%	0.50%	0.50%	0.60%	1.20%	2.00%

APPENDIX 3 Prudential and Treasury Indicators

TABLE 3: PRUDENTIAL INDICATORS	2009/10	2010/11	2011/12	2012/13	2013/14
Extract from 2011-12 Budget report and latest Capital Expenditure estimates	Actual	Probable outturn	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Capital Expenditure					
General fund	7,235	6,186	7,426	1,000	1,000
HRA	4,452	5,628	7,060	5,620	5,620
TOTAL	11,687	11,814	14,486	6,620	6,620
Ratio of financing costs to net revenue stream					
General fund	-0.35%	0.13%	0.15%	-0.71%	-2.03%
HRA	2.16%	2.25%	1.96%	1.96%	1.96%
Net borrowing requirement					
Brought forward 1 April	0	0	0	2,620	0
Carried forward 31 March	0	0	2,620	2,620	0
In year borrowing requirement	0	0	2,620	0	0

TABLE 3: PRUDENTIAL INDICATORS (contd)	2009/10	2010/11	2011/12	2012/13	2013/14
Extract from 2011-12 Budget report and latest Capital Expenditure estimates	Actual	Probable outturn	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Capital Financing Requirement as at 31 March					
General fund	-8	-336	-2,949	-2,949	-2,949
HRA	-3,190	-3,190	-570	-570	-570
TOTAL	-3,198	-3,526	-3,519	-3,519	-3,519
Annual change in Cap. Financing Requirement					
General fund - no borrowing expected	0	0	0	0	0
HRA	0	0	2,620	0	0
TOTAL	0	0	2,620	0	0
Incremental impact of capital investment decisions	£ p	£ p	£ p	£ p	£ p
Increase in council tax (band D) per annum	-0.04	-0.11	-0.71	-0.91	-1.18
Increase in average housing rent per week - HRA	0.00	0.00	-0.10	-0.13	-0.13

TABLE 4: TREASURY MANAGEMENT INDICATORS	2009/10	2010/11	2011/12	2012/13	2013/14
	Actual	Probable outturn	estimate	estimate	estimate
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt -					
Borrowing	2,000	2,000	8,000	91,500	91,500
Other long term liabilities	0	0	0	0	0
TOTAL	2,000	2,000	8,000	91,500	91,500
Operational Boundary for external debt -					
Borrowing	2,000	2,000	5,000	88,500	88,500
Other long term liabilities	0	0	0	0	0
TOTAL	2,000	2,000	5,000	88,500	88,500
Actual external debt	2,000	2,000	4,620	82,120	82,120
Upper limit for fixed interest rate exposure expressed as:-					
Net interest re fixed rate borrowing / investments	100%	100%	100%	100%	100%
Upper limit for variable rate exposure expressed as:-					
Net interest re variable rate borrowing / investments	100%	100%	100%	100%	100%
Upper limit for total principal sums invested for over 364 days (per maturity date)	50%	50%	50%	50%	50%

TABLE 5: Maturity structure of fixed rate borrowing during 2011/12	upper limit	lower limit
under 12 months	30%	0%
12 months and within 24 months	60%	0%
24 months and within 5 years	80%	0%
5 years and within 10 years	90%	0%
10 years and above	100%	25%

APPENDIX 4 Economic Background

Economic Background

4.1. Global economy

The Eurozone sovereign debt crisis peaked in May 2010 prompted, in the first place, by major concerns over the size of the Greek government's total debt and annual deficit. However, any default or write down of Greek debt would have substantial impact on other countries, in particular, Portugal, Spain and Ireland. This crisis culminated in the EU and IMF putting together a €750bn support package in mid May. A second crisis, this time over Ireland in November, culminated in Ireland also having to take a bail out. There was another crisis in early January 2011 when Portugal narrowly avoided having to resort to taking a similar bail out package. However, this looks as if Portugal has only delayed what appears to be inevitable so there are widespread expectations that there will be another sovereign debt crisis in 2011.

The unexpectedly high rate of growth in quarters 2 and 3 of 2010 in the UK and the Euro zone in Q2 were driven by strong growth in the construction sector catching up from inclement weather earlier in the year and by other short term factors not expected to be enduring; general expectations are for anaemic (but not negative) growth in 2011 in the UK and EU, though growth in the US looks as if it could be about twice as strong on the back of fiscal cuts increasing consumer disposable income and confidence..

4.2 UK economy

Following the general election in May 2010, the coalition government has put in place an austerity plan to carry out correction of the public sector deficit over the next five years. The result of fiscal contraction will be major job losses during this period, in particular in public sector services. This is likely to have a knock on effect on consumer and business confidence and appears to have also hit the housing market as house prices started on a generally negative trend from mid 2010. Mortgage approvals are also at very weak levels, all of which indicates that the housing market is likely to remain weak in 2011.

Economic Growth – GDP growth has peaked in the current period of recovery at 1.2% in quarter 2 of 2010. Growth in quarter 3 @ +0.7% was also unexpectedly high but the first estimate for Q4 was a huge shock at -0.5% and reflected the effect of snow in December. Overall, the outlook is for anaemic growth in 2011/12 and the Bank of England has downgraded its estimate for growth in 2011 from 2.6% to 2.0% in the February 2011 Inflation Report.

Unemployment – the trend for 2011 is likely to be one of steadily increasing unemployment.

Inflation and Bank Rate – CPI has remained high during 2010. It peaked at 3.7% in April and then gradually declined to 3.1% in September (RPI 4.6%) before returning to a rising path and hitting 4.0% in January 2011. The outlook is for further upward pressure with CPI to reach as much as 5% in early 2011 before starting to subside again. Although inflation has remained stubbornly above the MPC's 2% target, the MPC is confident that inflation will fall back over the next two years and should then be near to the target level.

The Bank of England finished its programme of quantitative easing (QE) with total purchases of £200bn by November 2009. However, major expectation that there could be a second round of quantitative easing in late 2010 or early 2011, to help support economic growth, evaporated after the surprises of the Q3 GDP figure of +0.7% and the November Inflation Report revising the forecast for short term inflation sharply upwards.

Sector's central view is that Bank Rate will start to increase in Q3 2011 (August) but there are risks both ways on this timing.

AAA rating – prior to the general election, credit rating agencies had been issuing repeated warnings that unless there was a major fiscal contraction, the UK's AAA sovereign rating was at

significant risk of being downgraded. Sterling was also under major pressure during the first half of the year. However, after the Chancellor's budget on 22 June 2010, Sterling strengthened against the US dollar and confidence has returned that the UK will retain its AAA rating. In addition, international investors viewed UK government gilts as being a safe haven from EU government debt during mid 2010. The consequent increase in demand for gilts helped to add downward pressure on gilt yields and PWLB rates during the first half of 2010/11.

4.3 Sector's forward view

It is currently difficult to have confidence as to exactly how strong UK economic growth is likely to be during 2011/12, and there are a range of views in the market. Sector has adopted a moderate view. There are huge uncertainties in all forecasts due to the major difficulties of forecasting the following areas:

- the strength / weakness of economic growth in our major trading partners - the US and EU
- the danger of currency war and resort to protectionism and tariff barriers if China does not adequately address the issue of its huge trade surplus due to its undervalued currency
- the degree to which government austerity programmes will dampen economic growth and undermine consumer confidence
- changes in the consumer savings ratio
- the speed of rebalancing of the UK economy towards exporting and substituting imports
- the potential, in the US, for more quantitative easing, and the timing of this, and its subsequent reversal in both the US and UK
- the speed of recovery of banks' profitability and balance sheet imbalances and the consequent implications for the availability of credit to borrowers
- the potential for a major EU sovereign debt crisis which could have a significant impact on financial markets and the global and UK economy
- political risks in the Arab world, Middle East and Korea and the knock on potential effects on oil production in the first two areas

The overall balance of risks is weighted to the downside. However, concerns around some residual risk of a double dip recession and deleveraging, creating a downward spiral of falling demand, falling jobs and falling prices, have now been replaced with concerns around the inflationary effects of increases in world commodity prices stoking the fires of inflation.

Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries. However, most of this increase has already occurred in the second half of 2010/11 as a result of a major change in market sentiment.

APPENDIX 5 Specified and Non-Specified Investments

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

	Minimum 'High' Credit Criteria	**Use**
UK Debt Management Agency Deposit Facility, including Treasury Bills	Government Backed	In-house and Fund Manager
Term deposits – local authorities	High Security – not credit rated	In-house
Term deposits – banks and building societies	Sector rating Green to Blue	In-house and Fund Managers (Maximum £6m in any one institution)
CD – banks and building societies	Short-term F1+, Long-term AA- , Individual B/C Support 1/2	Fund Managers
Money Market Funds	Long Term AAA	In-house and Fund Manager (Maximum limit of £4m in any one MMF in-house)
Bonds issued by multilateral development banks	Long term AAA	Fund Manager

Institutions will be removed from the list where there are doubts about their security. Any institution whose CDS rating is shown 'Out of Range' by Sector will be removed from the list. In addition, upper limits on deposits with any one institution will be reduced if there is the view that whilst they should not be removed from the list there are reasons to reduce the council's exposure.

Term deposits with nationalised banks and banks and building societies operating with government guarantees

	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period
UK nationalised banks	Sector rating Green to Blue	In-house and Fund Managers (Maximum £6m in any one institution)	**45% in house**	**364 days in house**
UK nationalised banks	Short-term F1+, Long-term AA- Individual B/C Support 1/2	Fund Managers	**N/A**	**N/A**
Banks nationalised by high credit rated (sovereign rating) countries – non UK	Short-term F1+, Long-term AA- Individual B/C Support 1/2	In-house and Fund Managers	**30% in house**	**364 days in house**
Government guarantee (explicit) on ALL deposits by high credit rated (sovereign rating) countries**	Short-term F1+, Long-term AA- Individual B/C Support 1/2	In-house and Fund Managers	**25% in house**	**364 days in house**
UK Government support to the banking sector (implicit guarantee) ***	Sector rating Green to Blue	In-house and Fund Managers	**45% in house**	**364 days in house**
UK Government support to the banking sector (implicit guarantee) ***	Sector rating Green to Blue	In-house and Fund Managers	**45% in house**	**364 days in house**

***The original list of banks covered when the support package was initially announced was: -

- Abbey (now part of Santander)
- Barclays
- HBOS (now part of the Lloyds Group)
- Lloyds TSB
- HSBC
- Nationwide Building Society
- RBS
- Standard Chartered

Banks eligible for support under the UK bail-out package and which have issued debt guaranteed by the Government are eligible for a continuing Government guarantee when debt issues originally issued and guaranteed by the Government mature and are refinanced. However, no other institutions can make use of this support as it closed to new issues and entrants on 28 February 2010. The banks which have used this explicit guarantee are as follows: -

- Bank of Scotland
- Barclays
- Clydesdale
- Coventry Building Society
- Investec bank
- Nationwide Building Society
- Rothschild Continuation Finance plc
- Standard Life Bank
- Tesco Personal Finance plc
- Royal Bank of Scotland
- West Bromwich Building Society
- Yorkshire Building Society

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

NON-SPECIFIED INVESTMENTS: These are investments which do not meet the requirement of specified investments. They must all be sterling denominated with a maximum invested of £17.5m of council funds. Please note that the Fund Manager restricts sums lent to each name to 20% and average maturity shall not exceed three years.

Maturities of up to three years

	Minimum Credit Criteria	**Use**	**Max % of total investments**	**Max. maturity period**
Term deposits – banks and building societies	Short-term F1+, Long-term AA, Individual B/C, Support 1/2	Fund Managers	50% restriction above 364 days	10 years
Certificates of deposits issued by banks and building societies	Short-term F1+ Long-term AA, Individual B/C, Support 1/2	Fund Managers	50% restriction above 364 days	10 years
UK Government Gilts	AAA	Fund Managers	50% restriction above 364 days	10 years
Bonds issued by multilateral development banks	AAA or government guarantee	Fund Managers	50%	Not to exceed 10 years
Bonds issued by a financial institution which is guaranteed by the UK government	AAA	Fund Managers	50% restriction above 364 days	Not to exceed 2 years
Sovereign bond issues (i.e. other than the UK govt)	AAA	Fund Managers	50%	Not to exceed 10 years
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)				
1. Bond Funds	Long-term AAA volatility rating	Fund Managers	50% restriction above 364 days	Open ended
2. Gilt Funds	Government backed and AAA	Fund Managers	50% restriction above 364 days	Open ended

APPENDIX 6 Approved countries for investments as at 24 February 2011

AAA

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

AA+

- Australia
- Belgium
- Hong Kong
- Spain

Please note that countries will move in and out of these rankings during the year and investment decisions will be made accordingly. Where investments are held with an institution whose sovereign rating is down-graded then advice will be sought at the time as to whether to withdraw the investment or let it run to maturity where relevant.

APPENDIX 7 Treasury management scheme of delegation

(i) Full council

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

(ii) Cabinet

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement
- budget consideration and approval

(iii) Audit Committee

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.
- receiving and reviewing regular monitoring reports and acting on recommendations

APPENDIX 8 The treasury management role of the section 151 officer

The S151 officer

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