CABINET – 26th February 2009

Report of the Chief Executive

ITEM 12 TREASURY MANAGEMENT AND INVESTMENT STRATEGY STATEMENT

Purpose of the Report

To bring to the attention of Cabinet the Council's Treasury Management and Investment Strategy Statement for the financial year 2009/10.

Recommendation

The Council are recommended:

To approve the Treasury Management Statement and Annual Investment Strategy 2009/10 attached as an appendix to the report, as the basis for the Council's treasury management and investment activity for 2009/10 financial year.

Reason

In guidance issued under the Local Government Act 2003, the approval by Council of an Annual Investment Strategy is required. This is also required as part of the CIPFA Treasury Management Code of Practice.

Policy Context

Having appropriate clearly stated and approved Treasury and Debt Management Policies in place are fundamental to having sound financial administration in place.

Background

A revised CIPFA Treasury Management Code of Practice was approved by Cabinet on February 5th 2009.This will be presented to Council on the March 2nd 2009. The approval of a Treasury Management and Investment Strategy Statement is required in that guidance. This document sets out the policies to be followed in the coming year in the area of treasury management and investment.

Information Supplied.

The Strategy Statement includes extracts on the borrowing limits and requirements for the next three financial years which are contained within the Prudential Guideline Report also presented to this Cabinet. The Strategy Statement also includes the forecast of the Council's treasury management consultants, Sector Treasury Services Ltd, on interest rate movements, and the strategy to be adopted by the Council's fund managers, Investec Ltd, over the next 12 months and the basis for its adoption.

As in previous years, the strategy of treasury management and investment has been combined, as they are closely related. The financial markets have recently seen the greatest turmoil for a least a generation and the lowest interest rates for over 300 years. Therefore it is necessary more than ever to keep a very close watch on market developments and, as before, act on the information supplied by treasury consultants and use market intelligence to obtain a fair return on investment whilst preserving capital security.

Conclusion

The statements are necessary to the sound governance of the Council and this demonstrates that this important area of Council activity is being given close attention. The management of investments and cash flow is an activity that, over many years, has shown substantial revenue income for the Council but it also crucial that this is not obtained by risking the capital of the authority. Therefore although of a technical nature, the consequences of these actions set out in the strategies are important to the financial stability of the Council.

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 rating used to minimise risks
Market changes rapidly during year	Medium	Medium	Although strategy in place, important to monitor position and use Treasury Consultant to provide latest advice.

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Background Papers: Local Government Act 2003
Prudential Code for Capital Finance in Local Authorities

CIPFA Code for Treasury Management
Report to Cabinet 26th February 2009 Prudential Guidelines

Key Decision: No

TREASURY MANAGEMENT STRATEGY STATEMENT and ANNUAL INVESTMENT STRATEGY 2009/10

1. INTRODUCTION

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

The Act also requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act); these set out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The suggested strategy for 2009/10 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 advisor. The strategy covers:

- treasury limits in force which will limit the treasury risk and activities of the Council;
- Prudential Indicators;
- the current treasury position;
- prospects for interest rates;
- the investment strategy;
- any extraordinary treasury issues (such as the implications of a ALMO).

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 2009/10 TO 2011/12

It is a statutory duty under S.3 of the Local Government Act 2003 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 section 3 of the Local Government Act 2003.
The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is 'acceptable'.

Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such

as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

3. PRUDENTIAL INDICATORS FOR 2009/10 – 2011/12

The following Prudential Indicators (in table 2 below) are relevant for the purposes of setting an integrated treasury management strategy.

The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This was adopted February 2004 by the full Council and a revised version is being presented to Council on March 2nd 2009

PRUDENTIAL INDICATOR	2007/08	2008/09	2009/10	2010/11	2011/12
(1). EXTRACT FROM BUDGET AND RENT SETTING REPORT	£'000	£'000	£'000	£'000	£'000
	actual	probable outturn	estimate	estimate	estimate
Capital Expenditure					
Non - HRA	4.400	5.206	12.993	2.802	1.572
HRA (applies only to housing authorities)	4.300	4.302	3.550	3.912	3.706
TOTAL	8.700	9.508	16.543	6.714	5.278
Ratio of financing costs to net revenue stream					
Non - HRA	-5.96%	-6.28%	-2.78%	-2.87%	-3.30%
HRA (applies only to housing authorities)	1.95%	2.28%	2.30%	2.17%	2.05%
Capital Financing Requirement as at 31 March					
HRA	-3.439	-3.227	-3.227	-3.227	-3.227
	18	-194	-194	-194	-194
General Fund					
Total	-3.421	-3.421	-3.421	-3.421	-3.421
Annual change in Cap. Financing Requirement					
No Borrowing planned	0	0	0	0	0
Incremental impact of capital investment decisions	£ p	£ p	£ p	£ p	£ p
Increase in council tax (band D) per annum	-£0.18	-£0.18	-£0.14	-.£0.14	-£0.14
Increase in average housing rent per week	£0.20	£0.03	£0	£0	£0

PRUDENTIAL INDICATOR	2007/08	2008/09	2009/10	2010/11	2011/12
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£'000	£'000	£'000	£'000	£'000
	actual	probable outturn	estimate	estimate	estimate
Authorised Limit for external debt - borrowing	£2,000	£2,000	£8,000	£8,000	£8,000
TOTAL	£2,000	£2,000	£8,000	£8,000	£8,000
Operational Boundary for external debt - borrowing	£2,000	£2,000	£5,000	£5,000	£5,000
TOTAL	£2,000	£2,000	£5,000	£5,000	£5,000
Upper limits for fixed interest rate exposure expressed as :- Net interest re fixed rate borrowing / investments	75 %	75%	75 %	75%	75%
Upper limits for variable rate exposure expressed as :- Net interest re variable rate borrowing / investments	100 %	100%	100%	100%	100%
Upper limits for total principal sums invested for over 364 days	50%	50%	50%	50%	50%

Maturity structure of fixed rate borrowing during 2009/10	upper limit	lower limit
under 12 months	20%	0
12 months and within 24 months	20%	0
24 months and within 5 years	20%	0
5 years and within 10 years	75%	0
10 years and above	90%	25%

CURRENT PORTFOLIO POSITION

The Council's treasury portfolio position at **13/02/09** comprised:

Borrowing by the Council	£m	Interest Rate
Market Loan – Variable Rate LOBO	2	11.625
Total	2	
Investments by the Council		
External Fund Manager	16.0	Annualised 2008/09 Return 6.6% (est.)
Internal Funds	13.3	Range 1.94% to 1.01%
Total	29.3	
(note that internal lending is greatly		
reduced in final month of the		
Financial Year)		

4. PROSPECTS FOR INTEREST RATES

The Council has appointed Sector Treasury Services as treasury adviser to the Council and part of their service is to assist the Council to formulate a view on interest rates. Appendix A 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 interest rate forecast – January 2009

	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009	Q/E1 2010	Q/E2 2010	Q/E3 2010	Q/E4 2010	Q/E1 2011	Q/E2 2011	Q/E3 2011	Q/E4 2011	Q/E1 2012
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.75%	2.50%	3.25%	3.75%	4.00%
5yr PWLB rate	2.50%	2.25%	2.15%	2.15%	2.15%	2.45%	2.80%	3.15%	3.65%	3.95%	4.20%	4.45%	4.60%
10yr PWLB rate	3.10%	2.75%	2.55%	2.55%	2.55%	2.85%	3.25%	3.65%	4.15%	4.40%	4.70%	4.75%	4.85%
25yr PWLB rate	4.00%	3.95%	3.95%	3.95%	4.00%	4.15%	4.35%	4.45%	4.60%	4.85%	4.95%	5.00%	5.05%
50yr PWLB rate	3.85%	3.80%	3.80%	3.80%	3.85%	3.90%	4.00%	4.25%	4.40%	4.70%	4.80%	4.95%	5.00%

Sector's current interest rate view is that Bank Rate: -

- will fall from current levels because of the intensifying global recession
- Starting 2009 at 2.00%, Bank Rate is forecast to fall to 0.5% in Q1 2009
- It is then expected to remain there until starting to rise gently up from Q2 2010 till it reaches 4.0% in Q1 2012.
- There is downside risk to these forecasts if the recession proves to be deeper and more prolonged than currently expected.

ECONOMIC BACKGROUND

Introduction

- The sub prime crisis of early 2008 was overtaken by the banking crisis of autumn 2008. The world banking system came near to collapse and governments around the world were forced to recapitalise and rescue their major banks. The resulting dearth of lending from banks anxious to preserve capital led to economic forecasts being sharply reduced and recession priced into markets. This in turn led to sharp falls in oil and other commodity prices with the result that inflation, which in the UK was running at over 5%, became yesterday's story and recession fears drove interest rate sentiment and policy. A co-ordinated global interest rate cut of 50bp took place on 8th October 2008. Forecasts in the UK were for further sharp cuts in interest rates as recession hove into view.

International

- Early in 2008 the US economy was being badly affected by the housing market slump. Interest rates were at 2% and inflation was being dragged higher by the inexorable rise in commodity prices. The ECB was very concerned about rising inflation and less about the state of the economy.
- The second quarter of 2008/9 was torn between inflation worries on the one hand, with oil rising towards $150 per barrel, and the deteriorating economic outlook on the other.
- In the second and third quarters of the year the financial crisis erupted and escalated as the world became aware of the extent of the sub-prime fiasco and the impact it was having on institutions that had invested in these issues.
- In September Fannie Mae/Freddie Mac (the mortgage banks) and AIG, the insurance giant, had to be bailed out by the US Federal Government.
- Then in mid September, Lehman Bros., the investment bank, was allowed to fail. This triggered a domino effect with other banks and financial institutions having to be rescued or supported by governments around the world.
- After the collapse into receivership of the Icelandic banks in early October, other countries then started to feel the strain and a number had to approach the IMF for support.
- Eventually even the Asian 'Tiger' economies were affected, including India and China, and it became clear that the crisis had become a global one and no country was insulated from it.
- The financial crisis had therefore precipitated an economic crisis and there was a co-ordinated global interest rate cut with the Fed, ECB and MPC all cutting rates by 50bp on 8th October. The Fed subsequently cut rates again by 50bp to 1% on 29th October and again on 16 December to a band of 0.0% to 0.25% in an attempt to stave off the oncoming recession. Inflation was yesterday's problem.
- On 4th November the USA elected Barack Obama as President with little immediate financial impact.
- The ECB reduced rates again on 6th November by 50bp and by its biggest ever cut of 75bp on 4 December to reach 2.5%.

UK

- GDP: growth was already slowing in 2008 from 2007 before the full impact of the credit crunch was felt. Earlier in 2008 GDP was 2.3% whereas in the autumn the figure fell back to -0.3% and was then expected to continue to be negative going into 2009.
- Wage inflation remained relatively subdued as the Government kept a firm lid on public sector pay. Private sector wage growth was kept in check by the slowing economy.
- Growth slowed across the economy and unemployment rose throughout the year with forecasts of 2 million unemployed by the end of the financial year and continuing to increase thereafter through 2010.
- Notwithstanding the pressures on household finances consumer spending still continued at a reasonable clip although the trend was slowing as the year progressed.
- Bank lending came to a virtual standstill in the autumn as the credit crunch tightened its grip and various banks internationally had to be rescued, or supported, by their governments.
- The Government and Bank of England supplied massive amounts of liquidity to the banking market in an attempt to reignite longer interbank lending.
- The Government took action in September to either supply finance itself to recapitalise some of the major clearing banks or to require the others to strengthen their capital ratios by their own capital raising efforts. This was so that these banks

would be seen to have sufficient reserves to last through the coming recession with its inevitable increase in bad loans etc.

- The housing market also came to a virtual standstill as lenders demanded larger deposits and higher fees. House sales and prices both dropped sharply.
- Government finances deteriorated as income from taxation dropped as the economy slowed and the cost of the bailout of the banks was added to the deficit.
- U.K. equity prices declined sharply in the 3rd and 4th quarters as the impending recession was priced into the markets. Prices hit five year lows and volatility was extremely high.
- The story of 2008 has been the credit crunch, the banking crisis and the change in economic outlook from slow growth to outright recession. After the initial concerns about the impact of the credit crunch in the earlier part of 2008 it appeared as though the storm had been weathered. The MPC had been very concerned about CPI inflation, which had been rising sharply on the back of higher commodity and food prices. Bank Rate reached a peak of 5.75% in July 2007 after which cuts of 0.25% occurred in December 2007 and February and April 2008 before the major cuts in the autumn. The economic data had been indicating a slowing economy for some while but it was not sufficiently weak to force the MPC into another cut. It was the strength of the banking crisis, pre-empted by the collapse of Lehmans in New York that eventually drove the MPC to cut interest rates by 50bp on October 8th in concert with the Federal Reserve, the ECB and other central banks. It was then appreciated that the economic downturn would be much more severe than previously thought and interest rates were subsequently slashed by 150bps on 6 November, 100bps on 4 December and 50 bps on 8 January 2009, with a further reduction on February 5 to 1%.
- The LIBOR spread over Bank Rate has also been a feature, and a concern, of 2008/9. Because of the credit fears and the reluctance of lenders to place cash for long periods 3 month LIBOR (this is the London Inter Bank Offer Rate – the rate at which banks will lend to one another) has been substantially higher than Bank Rate. This has meant that the MPC's power over monetary policy has been eroded by the widening of this spread between LIBOR and Bank Rate and it has therefore had a limited ability to bring relief to hard pressed borrowers through lower interest rates. However, the power of the Government over the semi nationalised clearing banks had considerable impact in enforcing pro rata reductions to the 150 bps Bank Rate cut in November on some borrowing rates, this will impact on cash lender of course.
- The Government has abandoned its 'golden rule'. The pre Budget Report on 14 November revealed the Government's plans for a huge increase in Government borrowing over coming years as a result of falling tax revenues and also due to tax cuts and increases in Government expenditure in the short term designed to help stimulate economic growth to counter the recession.
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- ANNUAL INVESTMENT STRATEGY

5.1 Investment Policy

The Council requires to have regard to the ODPM's Guidance on Local Government Investments ("the Guidance") issued in March 2004 and CIPFA's 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 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 below under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules. Guidance will be followed issued by the Council's Treasury Adviser.

SPECIFIED INVESTMENTS:

An investment is specified, as laid out in guidance from the Government under the LGA 2003, if it satisfies the conditions set out below, it is designed to require minimal procedural formalities:

- The investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling.
- The investment is not a long term investment i.e. it does not exceed 364 days duration
- The investment does not involve the acquisition of share capital or loan capital in any body corporate.
- Either of the following conditions is met:
    1. The investment is made with the UK Government or a local authority or a parish council or community council.
    2. The investment is made with a body or in an investment scheme which has been awarded a high credit rating by a credit rating agency (either Standard or Poor's, Moody's Investment Service Ltd or Fitch ratings Ltd.)

Form of Investment	Minimum 'High' Credit Criteria	Use
Debt Management Agency Deposit Facility	Govt. Backed	In-house and Fund Manager
Term deposits – local authorities (as defined)	High Security – not credit rated	In-house
Term deposits – banks and building societies	Short-term F1+, Long-term AA- Individual C Support 1/2	In-house and Fund Manager(max sum per lender £4m in house)
Certificates of deposits issued by banks and building societies	Short-term F1+ Long-term AA, Individual B/C, Support 1/2	Fund Manager
UK Government Gilts	Long term AAA	Fund Managers
Money Market Funds	Long Term AAA, Short Term F1+, Support MR1	Fund Manager/In - House
Bonds issued by multilateral development banks	Long term AAA	Fund Managers

The credit ratings are monitored daily by staff and counterparties that cease to meet the criteria would be removed from the list and not used until the ratings were restored. The ratings are shown above. Counterparties will change during the year as the market moves, and a sufficient choice is required in order to place deposits.
However, the longer term lending is currently being handled by the Fund Managers and the opportunity will be considered in the next financial year to develop this action to obtain more favourable rates.

Since the 'banking crisis' there have been a number of developments which require separate consideration and approval for use: -

Nationalised banks in the UK

These have credit ratings which do not conform to the credit criteria usually used by local authorities to identify banks which are of high credit worthiness. In particular, as they no longer are separate institutions in their own right, it is impossible for Fitch to assign them an individual rating for their stand alone financial strength. Accordingly, they have assigned an F rating which means that at a historical point of time, this bank failed and is now owned by the Government. However, these institutions are now recipients of an F1+ short term rating as they effectively take on the creditworthiness of the Government itself i.e. deposits made with them are effectively being made to the Government. They also have a support rating of 1; in other words, on both counts, they have the highest ratings possible. In particular the Northern Rock and Bradford and Bingley have been taken into control by the Government. Currently, they are not seeking funds in the market, but if they do so this would be an opportunity to use a F1+ lender.

Blanket guarantees on all deposits**.**

Some countries have supported their banking system by giving a blanket guarantee on ALL deposits e.g. Ireland. Authorities may view that the sovereign rating of that country then takes precedence over the individual credit ratings for the banks covered by that guarantee. Whilst this does provide a commitment by a country to stabilise the banking arrangement of a country, it still remains necessary to judge the financial stability of the country should the entire banking system require such a guarantee at the same time. Therefore market intelligence needs to be used regarding sovereign status.

The UK banking system support package.

The UK Government has NOT given a blanket guarantee on all deposits but has underlined its determination to ensure the security of the UK banking system by supporting eight named banks with an initial £500bn support package. Probably, without such a package, some of the major names in British banking would have failed, with a vast amount of savers' deposits at risk, including local authorities. The Council are using the credit ratings of the banks to judge the safety of deposits placed with these eight banks, rather than an implicit guarantee that the Government would not permit these to fail.

<u>Other countries**.**</u>

There are many large banks in the European Union and the rest of the world, some of these provide lending opportunities for local authority deposits and these are rated by agencies, as are UK banks. Also, of course, what appear to be UK banks are in fact owned overseas, e.g. Alliance and Leicester and the Abbey- both belong to Banco Santander, Spanish Bank. Clydesdale belongs to the National Australian Bank. Some countries have provided a guarantee on all deposits, (Ireland and Australia) some on selected deposits – Belgium, France and Luxembourg have guaranteed institutional investments in Dexia, for instance, for the period to October 2009. Fitch rate counties for their financial strength and sixteen are rated AAA, including the UK, Ireland and major European Countries. These investment opportunities require considering along with the other highly rated investment opportunities and judged on their credit ratings along with using market intelligence. The Council's Fund Manager uses high quality European banks for deposits.

Table of banking that has support from Government

	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period
Banks nationalised by high credit rated (sovereign rating) countries	Short-term F1+ Long-term A-, Individual F Support 1.	In-house and fund managers	25% in house	3 months or as long as guarantee exist from Government (In house)
Government guarantee on ALL deposits by high credit rated (sovereign rating) countries	Sovereign rating AAA	In-house and fund managers	25% In house	3 months (in house)
UK Government support to the banking sector**	Sovereign rating AAA	In-house and fund managers	100%	3 months (in house)

The above will be subject to an overall in house limit of £4m to each counterparty.

**Banks supported by the UK bail-out package: -

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

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 £15m of Council Funds. Note: The Fund Manager restricts sums lent to each name to 20% and average maturity of Fund shall not exceed three years.

Investment	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 Manager	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 Manager	50% restriction above 364 days	10 years
UK Government Gilts	AAA	Fund Manager	50% restriction above 364 days	10 years
Supranational Bonds	AAA or government guarantee	Fund Manager	50%	Not to exceed 10 years
Sovereign Bond Issues(other than UK Govt gilts): any maturity , sterling denominated,	AAA	Fund Manager	50%	Not to exceed 10 Years
Bonds issued by a financial institution which is guaranteed by the UK government	AAA	Fund Manager	50% restriction above 364 days	Not to exceed two years
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)				
1. Bond Funds	long-term AAA	Fund Managers	50% restriction above 364 days	Open ended
2. Gilt Funds	Govt backed	Fund Managers	50% restriction above 364 days	Open ended

The Council's external fund manager will comply with the Annual Investment Strategy. The agreement between the Council and the fund manager additionally stipulate guidelines and duration and other limits in order to contain and control risk.

The Council uses Fitch ratings to derive its counterparty criteria. Where counterparty does not have a Fitch rating, the equivalent Moody's rating will be used. All credit ratings will be monitored monthly and the Council is alerted to changes in Fitch ratings through its use of the Sector creditworthiness service. This is a daily service and is acted upon immediately.

- 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.

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

6.2 Investment Strategy

In-house funds*:*

The Council's in house investments are derived from the working balances and are cash flow driven. Council Tax and NNDR is payable by residents and businesses to the Council over a ten month period beginning in April and ending in January. However, amounts paid to the major preceptors continue to March, therefore sufficient cash has to be available to pay these amounts at year end. There is also a tendency within Councils' spending patterns to incur more expenditure towards the end of the financial year, both for revenue and capital.
Therefore, the in-house funds will not generally be available to lend in the longer term. There may be occasions where the capital receipts, and other contributions, are received and will be used later in the three year capital plan. These would provide an opportunity to lend for longer than one year, should the interest rates be favourable to this treatment, i.e. not on a rising market.
Otherwise, the in house funds would be lent as short term investments, which would be up to 364 days. The recent financial turmoil has seen the lending reduced to three months in order to be able to react to changes in the banking sector, particularly on the strength of lenders, and this has been at the expense of return. This would not necessarily be sound financial practice to continue in the long term. A return to 364 day or up to two year lending should be available as soon as the market position has become settled. Once the trough of the cycle has been reached, a rising market will provide the best returns at the short date.

An Indication of return from total security and market risk is shown in the following table

Average Funds available to invest	£30m example
Return at short term Government Investment rates currently 0.55% for three months	£165,000 (plus some compounding)
Return using current market rates and external Fund Manager	£481,000
Difference	£316,000 per annum

All investment, other than Government debt, involves a risk, but as can be seen above security comes at a price to the revenue return. Over a number of years this cost would amount to a very large sum of money. Therefore, is normal to use investments other than Government securities, but to take the utmost care possible in selecting counterparties.

Interest Rate –Outlook

Bank Rate started on a downward trend from 5.75% in December 2007 with further cuts of 0.25% in February and April 2008, then 0.5% in October, 1.5% in November and 1% in December. Further cuts of 1.5% are expected during Q1 2009 (one cut of 0.05% has occurred in January with another 0.5% in February) It is then expected to stabilise at 0.50% until starting to rise gradually with the first increase in Q2 2010 and then to be back up to 4.00% during Q1 2012.

Councils should therefore avoid locking into longer term deals while investment rates are down at historically low levels, and this would support the restriction to three month lending patterns.

For 2009/10 Sector are advising clients that they should budget for an investment return of 1.50% on investments placed during 2009/10, this assumes a spread over base rate of 100bps, at rate that is not being attained with a much restricted lending list and current base rate, or lower, is being attained. This will reduce if base rates continue to fall, as expected. In financial terms this is very serious for the Council. In 2007/08 an average in-house balance of £13.8m was lent out at a return of 5.78%, or £799K. If the same amount, on average was to be lent out during 2009/10 at the interest rates forecast be Sector the return would be £207K, around 75% lower. This could be a best position too, as it is proving difficult to obtain much over base with highest quality counterparties. This position will be subject to the economic factors of course, but is not expected to improve in 2009/10

For its cash flow generated balances, the Council will seek to utilise its business reserve accounts and short-dated deposits in order to benefit from the compounding of interest.

Fund manager's view on interest rates:

Currently, £15.9m (value date 31/12/08) of the Council's funds are externally managed on a discretionary basis by Investec. Their investment returns during 2008/09 have been extremely favourable for the Council as they have locked into higher rates at opportune times. Their overall estimate is a return of 6.6%. But this will not continue through to 2009/10 and as maturities need replacing the overall return will fall. Their view on a central case return is currently 2.25%, around 66% lower than the current year. This again will seriously reduce the Council's revenue funds.

Other Issues

The Council transferred the management of the Council House stock to an Arm's Length Management Company (Charnwood Neighbourhood Homes Ltd.) in December 2007. This company, should, after being judged to be two stars by the Housing Inspectorate, be able to access funds for the Decent Homes strategy. This will involve capital expenditure in excess of £30m and will require funding from borrowing for the Council with the cost being borne by subsidy through the HRA. This will therefore require the Council to carefully draw together a strategy for borrowing; however, this is now not forecast to apply to the financial year 2009/10.

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 Report to the Performance Scrutiny Committee.

ICELANDIC BANK INVESTMENTS

This authority currently has the following investment frozen in Icelandic banks

£1m - Heritable Bank Ltd.

The Icelandic Government has stated its intention to honour all its commitments as a result of their banks being placed into receivership. The U.K. Government is working with the Icelandic Government to help bring this about. At the current time it is not possible to say with certainty that the Council will recover the entirety of its investment

or when reimbursements will be made to this authority. The Local Government Association is coordinating the efforts of all UK authorities with Icelandic investments. Members will be periodically updated on the latest developments on these efforts.

The Government informed local authorities in November 2008 that it intends to make a regulation to require local authorities to delay recognising any loss on these investments that may eventually be incurred until the financial year 2010-11.