

**TELFORD & WREKIN COUNCIL**

**COUNCIL – 4 MARCH 2010**

**TREASURY MANAGEMENT STRATEGY AND UPDATE**

**REPORT OF THE CHIEF FINANCE OFFICER AND HEAD OF FINANCE**

**1. PURPOSE**

- To update Members on Treasury Management activities during 2009/10,
- To present the Treasury Management Strategy including borrowing limits and prudential indicators, Minimum Revenue Provision Policy and Annual Investment Strategy for 2010/11 for approval by Council.

**2. RECOMMENDATIONS**

Members are asked to approve the following recommendations from 23<sup>rd</sup> February Cabinet:

- (i) Approval of the Treasury Management Strategy (Sections 6.1 to 6.9),
- (ii) Minimum Revenue Provision Policy (Appendix 3)
- (iii) Investment Strategy (Section 6.10) for 2010/11 as outlined in the report.

And to adopt the revised Cipfa Treasury Management Code of Practice 2009 and revised Treasury Management Statement (Appendix 7).

**3. SUMMARY**

The report updates members on the recent Treasury Management activities undertaken and presents the proposed Treasury Management Strategy including Borrowing Limits and Prudential Indicators for 2010/11 together with the Minimum Revenue Provision Policy and the Investment Strategy for approval. The strategies and policies follow CLG and Cipfa Guidance.

The Audit Committee have scrutinised the Treasury Strategy at their meetings on the 2 and 10 February 2010 and comments arising from the 2 February meeting have been incorporated. The Committee may, within their terms of reference, make recommendations to Cabinet.

A glossary of terms is attached at Appendix 6

#### 4. **PREVIOUS MINUTES**

Council 25 June 2009

Council 5 March 2009

#### 5. **2009/10 TREASURY MANAGEMENT UPDATE**

##### 5.1 **CURRENT PORTFOLIO POSITION AS AT 31/12/09**

		Principal		Ave. rate
		£m	£m	%
Fixed rate funding	PWLB	53.0		
	Market	<u>55.0</u>	108.0	3.9
Variable rate funding	PWLB	0.00		
	Market	<u>13.6</u>	13.6	0.4
TOTAL DEBT			<u>121.6</u>	3.1
INVESTMENTS				
Fund Managers			39.5	0.9
In House			46.8	5.2
TOTAL INVESTMENTS			<u>86.3</u>	3.2

##### 5.2 **INTEREST RATES**

Base rates started the year at 0.5%, and have remained there all year. The Bank Of England has extended it's Quantative Easing programme during the year and it now stands at £200bn. The next move in base rate is expected to be up but not until late 2010 and will be strongly linked to how soon the economy recovers.

##### 5.3 **BORROWING & RESCHEDULING**

The borrowing strategy for the current year has been to use maturing investments to reduce borrowing and we have also reduced the number of Fund Managers from 3 to 2 and used the funds to reduce borrowing. Only temporary borrowing has been undertaken for the year to date. A summary of the transactions for the year to date is shown below.

###### **Rescheduling**

During 2009/10 the Council has taken the opportunity to reschedule 2 loans as detailed below, one of the loans had a premia on it but this was fully offset by the discount on the other loan, these were both replaced by temporary borrowing at very low interest rates. Any discounts achieved as part of these

transactions have to be spread over the remaining life of the loan or 10 years whichever is the shorter, whereas premia is spread over 25 years. The net impact on the budget will be a saving for the first 10 years of £14k together with the impact of a lower cost of borrowing which will save around £650k in interest in 2009/10 with the benefit continuing into 2010/11.

Date	Action	Amount £m	Impact on the Budget
22/04/09	Repaid - 4.25% loan	10.000	Discount £213,378
22/04/09	Repaid - 4.50% loan	7.000	Premia £190,691

### **New Borrowing**

Recently 2 PWLB loans have been taken both for £5m and 4 years. These are replacing 2 PWLB loans that mature during 2010/11 and are at similar rates. The borrowing has been undertaken in advance to take advantage of current favourable rates. Rates are predicted to increase over the next few months.

Between the period 1 June 2009 (previous Member update) and 31 December 2009, £141.3M of temporary loans have been raised in order to fund short-term cash flow requirements at various points. Interest rates have ranged from 0.25% to 0.36%-interest rates have remained fairly low during this time. £13.6m of this temporary borrowing was outstanding at 31 December 2009.

## **5.4 INVESTMENTS**

The strategy for the current year is: To gain maximum benefit, subject to risk control parameters, whilst achieving as a minimum target the 7 day deposit rate.

### **5.4.1 Fund Managers**

The average value of the portfolios held by the two fund managers in the nine months to 31 December 2009 are as follows:

	<b>Average Capital Value £m</b>	<b>Interest Year to date (annualised %)</b>	
	<b>£m</b>	<b>£m</b>	<b>%</b>
Invesco	19.639	0.057	0.5
Investec	<u>19.695</u>	<u>0.202</u>	<u>1.3</u>
	<u>39.334</u>	<u>0.259</u>	<u>0.9</u>

- We gave notice to Aviva, the Council's third fund manager, to close the fund and all of the monies were returned to the Council by 31 October 2009.

It has been very difficult for Fund Managers to achieve reasonable rates of return in the current climate. The outlook for 2010/11 is only slightly more

promising. This will be offset by the low rates we will be paying on our temporary borrowing during 2010. At the end of 2009/10 we anticipate that investments with fund managers will have reduced by around 50% from the opening position to approximately £30m. This reflects our view on the impact of the current interest rates and future movements in interest rates and the ability of fund managers to add value in this environment over and above what we can achieve in house.

#### 5.4.2 In-House Investments

The majority of the Council's investments are internally managed- a mix of both temporary investments for cash flow purposes and longer term investments are undertaken internally:

##### Temporary Investments

A proportion of funds are invested by the Council's own officers in order to maximise returns from day to day cash flows. The target return is to achieve at least the seven day deposit rate.

In total £131.2m of investments were placed between 1 June and 31 December. Interest rates have ranged from 0.25% to 0.75% and periods ranged from overnight deposits to 5 days. £46.85m in house temporary investments were held at 31 December 2009.

##### Longer Term Investments

A number of internally managed deposits have been made previously as an alternative to fund managers. These are as follows.

		£m	%
Fixed Deposit	22/01/07 – 24/01/11	5.0	5.52
Fixed Deposit	01/10/08 – 01/10/13	5.0	6.62
Fixed Deposit	02/10/08 – 02/10/13	5.0	6.80
Variable Deposit	30/07/08 – 30/07/12	10.0	0.84
Fixed Deposit	03/08/09 – 01/08/14	5.0	6.32
Fixed Deposit	06/03/09 – 06/03/14	5.0	6.31
Fixed Deposit	31/03/09 – 31/03/14	5.0	6.37
Fixed Deposit	22/04/09 – 22/04/14	5.0	6.35
Total		45.0	

It should be noted that the current guidance from our Treasury Advisors and our investment policy would mean that investments would not currently be placed for longer than 2 years. However these investments were placed before the start of the financial crisis and advice on the length investments should be placed was shortened and the council is benefiting from a very attractive return.

Overall the weighted average return on internal investments for the year to date was 5.46% compared to a benchmark return for the period of 0.43%

representing an additional £2.7m generated to support the Council's revenue budget.

### Supranational Bonds

Another form of investment undertaken internally is in the form of Supranational Bonds. The Council held an average of £4.0m of investments in a Supranational bond which was returning an average rate of 5.28% for 2009/10. This bond matured in December 2009.

#### **5.4.3 Overall Position and Exposure**

A full analysis of all Council investments at the end of December is shown in Appendix 1.

Appendix 2 shows the Council's total investment with each counterparty. Potentially, each investment manager may place £5m of the funds managed on the Council's behalf with the same institution that the Council has placed up to £5m with (except for Royal Bank of Scotland, National Australia Bank and Barclays which are ring fenced for sole use by the council), giving a current maximum potential exposure to any one counterparty of £15m. We have a number of investments that were placed before we reduced from 3 to 2 fund managers and this has resulted in £20m with some counterparties, so our limit will remain at £20.0m until those investments mature. At the end of December the greatest exposure with a single counterparty was £20.0m with Barclays (23.2% of the total portfolio).

Supranational bonds have a much higher credit rating than normal investments and we are secure with a potential higher exposure as a consequence. Potentially, each investment manager may place £10m of the funds managed on the Council's behalf with the same institution that the Council has placed up to £15m with, giving a current maximum potential exposure to any one counterparty of £35m. At the end of December the greatest exposure with a single counterparty was £1.1m with European Investment Bank (just over 1.3% of the total portfolio).

The Council is guided by its Treasury advisers Sector in assessing investments.

#### **5.5 LEASING**

Each year the Council arranges operating and finance leases for assets such as vehicles, computers and equipment. This helps to spread the cost over a number of years.

The first drawdown for 2009/10 was on 29 September. The drawdown from JCB Finance and CHG Meridian totalled £0.075m and funded the purchase of vehicles and ICT equipment over three, five and seven year periods at interest rates between 2.25% and 3.47%.

The next leasing drawdown of the current year is due to take place in March.



## **6. TREASURY STRATEGY FOR 2010/11 to 2012/13**

### **6.1 BACKGROUND**

#### **6.1.1 The Revised CIPFA Treasury Management Code of Practice 2009**

In the light of the Icelandic situation in 2008, CIPFA has amended the CIPFA Treasury Management in the Public Services Code of Practice (the Code), Cross-Sectoral Guidance Notes and Guidance Notes and the template for the revised Treasury Management Policy Statement. It is also a requirement of the Code that this Council should formally adopt the Code. As the Code has been revised, there is a separate appendix to this report where the Council is asked to adopt the revised Code and the revised Treasury Management Policy Statement (Appendix 7 and 8).

The revised Code has emphasised a number of key areas including the following: -

- a) All councils must formally adopt the revised Code and four clauses
- b) The strategy report will affirm that the effective management and control of risk are prime objectives of the Council's treasury management activities.
- c) The Council's appetite for risk must be clearly identified within the strategy report and will affirm that priority is given to security of capital and liquidity when investing funds and explain how that will be carried out.
- d) Responsibility for risk management and control lies within the organisation and cannot be delegated to any outside organisation.
- e) Credit ratings should only be used as a starting point when considering risk. Use should also be made of market data and information, the quality financial press, information on government support for banks and the credit ratings of that government support.
- f) Councils need a sound diversification policy with high credit quality counterparties and should consider setting country, sector and group limits.
- g) Borrowing in advance of need is only to be permissible when there is a clear business case for doing so and only for the current capital programme or to finance future debt maturities.
- h) The main annual treasury management reports MUST be approved by full council.
- i) There needs to be, at a minimum, a mid year review of treasury management strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved.
- j) Each council must delegate the role of scrutiny of treasury management strategy and policies to a specific named body.
- k) Treasury management performance and policy setting should be subjected to prior scrutiny.
- l) Members should be provided with access to relevant training.
- m) Those charged with governance are also personally responsible for ensuring they have the necessary skills and training.

- n) Responsibility for these activities must be clearly defined within the organisation.
- o) Officers involved in treasury management must be explicitly required to follow treasury management policies and procedures when making investment and borrowing decisions on behalf of the Council (this will form part of the updated Treasury Management Practices).

This strategy statement has been prepared in accordance with the revised Code. Accordingly, the Council's Treasury Management Strategy will be approved annually by the full council and there will also be a mid year report. In addition there will be monitoring reports and regular review by board members/councillors in both executive and scrutiny functions. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

This Council will adopt the following reporting arrangements in accordance with the requirements of the revised Code: -

<b>Area of Responsibility</b>	<b>Council/ Committee/ Officer</b>	<b>Frequency</b>
Treasury Management Policy Statement (revised)	Full council	Initial adoption in 2010
Treasury Management Strategy / Annual Investment Strategy / MRP policy	Full council	Annually before the start of the year
Treasury Management Strategy / Annual Investment Strategy / MRP policy – mid year report	Full council	Mid year
Treasury Management Strategy / Annual Investment Strategy / MRP policy – updates or revisions at other times	Full council	As required
Annual Treasury Outturn Report	Full council	Annually by 30 September after the end of the year
Treasury Management Monitoring Updates	Cabinet	Quarterly
Treasury Management Practices	Head of Finance	As required
Scrutiny of treasury management strategy	Audit Committee	Annually before the start of the year
Scrutiny of treasury management performance	Audit Committee	Quarterly

## 6.1.2 Revised CIPFA Prudential Code

CIPFA has also issued a revised Prudential Code which primarily covers borrowing and the Prudential Indicators. Three of these indicators have now been moved from being Prudential Indicators to being Treasury Indicators: -

- authorised limit for external debt
- operational boundary for external debt
- actual external debt.

However, all indicators are to be presented together as one suite. In addition, where there is a significant difference between the net and the gross borrowing position, the risks and benefits associated with this strategy should be clearly stated in the annual strategy.

### **6.1.3 Revised Investment Guidance**

It should also be noted that the Department of Communities and Local Government is currently undertaking a consultation exercise on draft revised investment guidance which will result in the issue of amended investment guidance for English local authorities to come into effect from 1 April 2010. A separate report will be made to members to inform them when this guidance has been finalised. It is not currently expected that there will be any major changes required over and above the changes already required by the revised Code.

### **6.1.4 Treasury Management Strategy for 2010/11**

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 issued subsequent to the Act) (included as paragraph 6.10 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 suggested strategy for 2010/11 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.

The strategy covers:

- treasury limits and prudential indicators in force which will limit the treasury risk and activities of the Council (Section 6.2);
- the projected portfolio position (Section 6.3);

- the borrowing requirement (Section 6.4);
- prospects for interest rates (section 6.5);
- the borrowing strategy (Section 6.6);
- Policy on borrowing in advance of need (Section 6.7);
- debt rescheduling (Section 6.8);
- the investment strategy (Section 6.10);
- creditworthiness policy (Section 6.10.2);
- policy on use of external service providers (Section 6.10.7);
- the MRP Strategy (Section 7);

### **6.1.5 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.

## **6.2 STATUTORY TREASURY LIMITS AND PRUDENTIAL INDICATORS FOR 2010/11 to 2012/13**

**6.2.1** 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” or “Authorised Limit for External Debt”. In England and Wales the authorised limit represents the legislative limit specified in section 3 of the Local Government Act 2003.

**6.2.2** 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 levels is ‘acceptable’.

**6.2.3** 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.

**6.2.4** The following prudential indicators (in table below) are relevant for the purposes of setting an integrated treasury management strategy.

**6.2.5** The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This was adopted on 7 March 2002 by Full Council and the revised code will be adopted on 4 March 2010.

PRUDENTIAL INDICATOR	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
	Probable Outturn	Estimate	Estimate	Estimate	Estimate	Estimate
<b>(1). EXTRACT FROM BUDGET SETTING REPORT</b>						
<b>Impact of capital investment decisions</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Revenue Impact – In Year		0.389	1.431	1.765	-0.053	-0.352
Revenue Impact – Cumulative		0.389	1.820	3.585	3.532	3.180
	<b>£p</b>	<b>£p</b>	<b>£p</b>	<b>£p</b>	<b>£p</b>	<b>£p</b>
Increase in council tax (band B, in year) (full year ongoing impact is £46.80 from 2015/16 onwards)	4.22	6.47	30.25	58.84	59.39	55.29
<b>Capital Expenditure</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
	69.263	95.510	95.350	97.560	71.762	73.442
<b>Ratio of financing costs to net revenue stream</b>						
	2.19%	2.95%	3.90%	4.60%	4.00%	3.60%
<b>Net borrowing requirement</b>						
Brought forward 1 April	189.123	135.000	182.457	214.121	213.179	219.892
Carried forward 31 March	135.000	182.457	214.121	213.179	219.892	198.966
In year borrowing requirement	-54.123	47.457	31.664	-0.942	6.713	-20.926
<b>In year Capital Financing Requirement</b>	<b>15.851</b>	<b>42.857</b>	<b>26.246</b>	<b>-7.229</b>	<b>-0.145</b>	<b>-27.594</b>
<b>Capital Financing Requirement (as at 31 March)</b>	<b>135.945</b>	<b>178.802</b>	<b>205.048</b>	<b>197.819</b>	<b>197.674</b>	<b>170.080</b>

PRUDENTIAL INDICATOR	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
<b>(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS</b>						
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
<i>Authorised limit for external debt</i>						
Borrowing	300	300	330	340	340	330
Other long term liabilities	6	6	7	8	8	8
<b>TOTAL AUTHORISED LIMIT</b>	<b>306</b>	<b>306</b>	<b>337</b>	<b>348</b>	<b>348</b>	<b>338</b>
<i>Operational Boundary</i>						

PRUDENTIAL INDICATOR	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
<b>(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Borrowing	280	280	310	320	320	310
Other long term liabilities	4	4	5	6	6	6
<b>TOTAL</b>	<b>284</b>	<b>284</b>	<b>315</b>	<b>326</b>	<b>326</b>	<b>316</b>
<i>Upper and lower limit for fixed interest rate exposure</i>						
Expressed as :-						
Net principal re fixed rate borrowing / investments: - Upper	190	190	200	210	210	210
- Lower	-10	-10	-10	-10	-10	-10
<i>Upper limit for variable rate exposure</i>						
Expressed as -						
Net principal re variable rate borrowing / investments	0	0	0	0	0	0
Upper limit for variable rate exposure expressed as						
Net principal re gross variable rate borrowing and investments divided gross borrowing plus investments	80%	80%	80%	80%	80%	80%
<b>Upper limit for total principal sums invested for over 364 days (per maturity date)</b>	<b>90%</b>	<b>90%</b>	<b>90%</b>	<b>90%</b>	<b>90%</b>	<b>90%</b>

Maturity structure of fixed rate borrowing	Lower Limit	Upper limit
Under 12 months	0%	20%
12 months and within 24 months	0%	25%
24 months and within 5 years	0%	50%
5 years and within 10 years	0%	75%
10 years and above	25%	100%

Credit ratings and counterparty limits for investments are discussed in 6.10.

### 6.3 PROJECTED PORTFOLIO POSITION FOR 2010/11

The Council's estimated treasury portfolio position at 01/04/10 is projected to e:

		<b>Principal</b>		<b>Ave. rate</b>
		£m		%
Fixed rate funding	PWLB	63.0		
	Market	<u>55.0</u>	118.0	3.6
Variable rate funding	PWLB	0.00		
	Market	<u>5.0</u>	5.0	2.0
<b>TOTAL DEBT</b>			<u><u>123.0</u></u>	3.5
<b>INVESTMENTS</b>				
Fund Managers			30.0	2.0
In House			45.0	5.0
<b>TOTAL INVESTMENTS</b>			<u><u>75.0</u></u>	3.8

### 6.4 BORROWING REQUIREMENT

	2010/11	2011/12	2012/13
	£m	£m	£m
	Estimate	Estimate	Estimate
New borrowing	47.5	31.7	-0.9
Alternative financing arrangements (Leasing)	1.0	1.0	1.0
Replacement borrowing	0.0	0.0	0.0
<b>TOTAL</b>	<b>48.5</b>	<b>32.7</b>	<b>0.1</b>

### 6.5 PROSPECTS FOR INTEREST RATES

**6.5.1** The Council appointed Sector Treasury Services as the treasury adviser to the Council and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the UBS forecast, which is Sector's central view and following that is their view of economic prospects and potential borrowing strategies:

## 6.5.2 Sector View interest rate forecast – December 2009

	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Mar-12	Mar-13
Bank rate	0.50%	0.50%	0.50%	0.75%	1.00%	1.50%	3.50%	4.50%
5yr PWLB rate	2.85%	3.05%	3.20%	3.30%	3.40%	3.60%	4.60%	4.85%
10yr PWLB rate	3.90%	4.00%	4.05%	4.15%	4.30%	4.45%	5.00%	5.15%
25yr PWLB rate	4.40%	4.55%	4.65%	4.70%	4.80%	4.90%	5.20%	5.35%
50yr PWLB rate	4.45%	4.60%	4.70%	4.75%	4.90%	5.00%	5.30%	5.45%

## 6.5.3 Sector's current Bank Rate view is as follows: - Sector Bank Rate forecast for financial year ends (March)

- 2010 0.50%
- 2011 1.50%
- 2012 3.50%
- 2013 4.50%

There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected.

## 6.5.4 Economic background

### Introduction

- The credit crunch storm of August 2007 eventually fed through to the near collapse of the world banking system in September 2008. This then pushed most of the major economies of the world into a very sharp recession in 2009 accompanied by a dearth of lending from banks anxious to rebuild their weakened balance sheets. Many governments were forced to recapitalise and rescue their major banks and central banks precipitately cut their central bank rates to 0.10 – 1.00% in order to counter the recession.

Inflation has fallen considerably and some economies have moved out of recession although the UK has lagged behind. The uncertainty is whether we will experience a double dip recession, where economies begin to emerge from recession only to plunge back in. This could have a significant impact on how interest rates move in the coming few years.

Further economic background information is contained in Appendix 4.

## 6.6 BORROWING STRATEGY

6.6.1 In view of the interest rate forecast shown above the Council's borrowing strategy for the year has to be flexible to take account of market conditions and developments and will be based upon the following views: -

- Rates are expected to gradually increase during the year so it should therefore be advantageous to time new long term borrowing for the start of the year when 25 year PWLB rates fall back to or below the central forecast rate of about 4.65%, a suitable trigger point for considering new fixed rate long term borrowing.
- Variable rate borrowing is expected to be cheaper than long term borrowing and will therefore be attractive in the short term throughout the financial year compared to taking long term fixed rate borrowing.
- PWLB rates on loans of less than ten years duration are expected to be substantially lower than longer term PWLB rates offering a range of options for new borrowing which will spread debt maturities away from a concentration in long dated debt.
- There is expected to be little difference between 25 year and 50 year rates so therefore loans in the 25-30 year periods could be seen as being more attractive than 50 year borrowing as the spread between the PWLB new borrowing and early repayment rates is considerably less. This would maximise the potential for debt rescheduling and allow the Council to rebalance its debt maturity profile.
- Consideration will also be given to borrowing fixed rate market loans at 25 – 50 basis points below the PWLB target rate and to maintaining an appropriate balance between PWLB and market debt in the debt portfolio.

### External v. internal borrowing

- This Council currently has a difference between gross debt and net debt (after deducting cash balances), of £86.3m.
- The general aim of this treasury management strategy is to reduce the difference between the two debt levels over the next three years in order to reduce the credit risk incurred by holding investments. However, measures taken in the last year have already reduced substantially the level of credit risk (see paragraph 6.10 below) so another factor which will be carefully considered is the difference between borrowing rates and investment rates to ensure the Council obtains value for money once an appropriate level of risk management has been attained to ensure the security of its investments.
- The next financial year is expected to be one of historically abnormally low Bank Rate. This provides a continuation of the current window of opportunity for local authorities to fundamentally review their strategy of undertaking new external borrowing.
- 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.
- The running down of investments also has benefits of reducing exposure to interest rate and credit risk.
  - However, short term savings by avoiding new long term external borrowing in 2010/11 will also be weighed against the potential for incurring long term extra costs by delaying unavoidable new external borrowing until later years when PWLB long term rates are forecast to be significantly higher.
  - The Council has examined the potential for undertaking early repayment of some external debt to the PWLB in order to reduce the difference between its gross and net debt positions. However, the introduction by the PWLB of significantly lower repayment rates than new borrowing rates in November 2007 has meant that large premiums would be incurred by such action and would also do so in the near term; such levels of premiums cannot be justified on value for money grounds. This situation will be monitored in case the differential is narrowed by the PWLB or when repayment rates rise substantially
  - During 2009/10 the Council has reduced its investments, and therefore its need to borrow, by £55m. A further reduction in investments of £10m will be made before the end of the financial year. The position will be kept under review as we move into 2010/11.

Against this background caution will be adopted with the 2010/11 treasury operations. The Chief Finance Officer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to Cabinet and Audit Committee on a regular basis.

Sensitivity of the forecast – In normal circumstances the main sensitivities of the forecast are likely to be the two scenarios noted below. The Council's officers, in conjunction with the treasury advisors, 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.

## **6.7 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.

## **6.8 DEBT RESCHEDULING**

**6.8.1** The introduction of the new PWLB rates structure on 1 November 2007 that introduced a spread between the rates applied to new borrowing and repayment of debt, has meant that PWLB to PWLB debt restructuring is now much less attractive than before that date. However, significant interest savings may still be achievable through using LOBOs (Lenders Option Borrowers Option) loans and other market loans in rescheduling exercises.

As short term borrowing rates will be considerably cheaper than longer term rates, there are likely to be significant opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of their short term nature and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio. Any such rescheduling and repayment of debt is likely to cause a flattening of the Council's maturity profile as in recent years there has been a skew towards longer dated PWLB.

Consideration will also be given to the potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings,
- helping to fulfil the strategy outlined in paragraph 6.6 above, and
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

There has been much discussion as to whether the size of spread between long term PWLB repayment and new borrowing rates should be revised (downwards) in order to help local authorities currently dissuaded from using investment cash balances to repay long term borrowing and thereby reduce counterparty and interest rate risk exposure. This authority will monitor developments in this area and amend its strategy in the light of such developments if they should occur.

All rescheduling will be reported to the Cabinet and Audit Committee.

## **6.9 OTHER ISSUES**

**6.9.1** The Council has a large PFI scheme contract in place which may have an impact on the strategy for later years. Under amendments to accounting practice this is being brought onto the balance sheet in 2009/10 and will result in the prudential limits for authorised and operational borrowing having to be increased. This is a technical adjustment and does not mean that the Council has to increase its borrowing.

## **6.10 ANNUAL INVESTMENT STRATEGY 2010/11**

### **6.10.1 Investment Policy**

The Council will have regard to the CLG's Guidance on Local Government Investments ("the Guidance") issued in March 2004, any revisions to that guidance, the Audit Commission's report on Icelandic Investments 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 below under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

### **6.10.2 Creditworthiness policy**

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

This Council uses the creditworthiness service provided by Sector Treasury Services. This service has been progressively enhanced over the last year 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
- 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, credit outlooks and CDS spreads in a weighted scoring system 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. For new investments 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

This 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 are currently very much more aggressive in giving low ratings than the other two agencies. This would therefore be unworkable and leave the Council with too few banks on its approved lending list. The Sector creditworthiness service does though, use ratings from all three agencies, but by using a scoring system, does not give undue preponderance to just one agency's ratings.

All credit ratings will be monitored daily and checked before any investment is placed.. 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. Where we have investments with a counterparty that is subsequently downgraded the action to take in relation to that investment will be considered on an individual basis.
- 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 Councils lending list.

Sole reliance will not be placed on the use of this external service in relation to investment or disinvestment decisions. In addition this Council will also use market data and intelligence, information on government support for banks and the credit ratings of that government support.

### 6.10.3 Exposure to Risk

The authority's activities expose it to a variety of financial risks:

- **credit risk** – the possibility that other parties might fail to pay amounts due to the authority
- **liquidity risk** – the possibility that the authority might not have funds available to meet its commitments to make payments
- **market risk** – the possibility that financial loss might arise for the authority as a result of changes in such measures as interest rates and stock market movements.

The authority's overall Treasury risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the resources available to fund services. Risk management on investments is carried out by a central treasury team, under policies approved by the council in the annual treasury management strategy. The council provides written principles for overall risk management, as well as written policies covering specific areas, such as interest rate risk, credit risk, and the investment of surplus cash.

#### **Credit risk**

A Guide to credit ratings is shown in Appendix 5.

Credit risk arises from deposits with banks and financial institutions, as well as credit exposures to the authority's customers.

Deposits are not made with banks and financial institutions unless they are rated independently with a minimum short term rating of F1+, a minimum long term rating of AA-, a minimum support rating of 3, a minimum individual rating of C and a minimum sovereign rating of AA-.

The Council uses Sectors credit rating matrix which shows for each institution their current ratings and overlays this with information in relation to credit default swaps to produce a suggested duration for investment, this currently starts from nil days (i.e. do not invest) up through various periods to a current maximum of 2 years. Only the highest credit quality achieving a suggested duration of 2 years. The authority has a policy of not lending more than 30% of its surplus balances to one institution.

The Council has not experienced any defaults with any of its investment counterparties. No credit limits were exceeded during the reporting period and the authority does not expect any losses from non-performance by any of its counterparties in relation to deposits and bonds. The Council has a number of long term (greater than 1 year) investments, the majority of these are with UK

banks that are within the UK Government Guarantee Scheme and pose very little risk of default. The current market conditions are unprecedented and our position will be continually monitored. Some of our investments met the criteria in place at the time invested, however due to changes in the market, they would no longer meet our current criteria. Each of these has been assessed individually and we anticipate no problems from continuing to hold those investments.

### **Sovereign exposure**

The council is proposing to introduce a new criteria from 2010/11. When the financial crisis arose in 2008 some authorities were excessively exposed to Icelandic banks. Some had all their investments with the various Icelandic banks and thus had 100% exposure to Iceland. As an additional safeguard we will be limiting our exposure to any one country (other than the UK) to 20% of our investments. This will be monitored and reviewed and where appropriate action taken if any sovereign exposure nears this limit. There is no limit on the amount of investments we can place in the UK. Supranational bonds are outside of this limit as they are multi government instruments and AAA rated (the highest rating given by rating agencies).

### **Liquidity risk**

As the authority has ready access to borrowings from the Public Works Loans Board, there is no significant risk that it will be unable to raise finance to meet its commitments in relation to financial instruments. Instead, the risk is that the authority will be bound to replenish a significant proportion of its borrowings at a time of unfavourable interest rates. The strategy is to ensure that not more than 40% of fixed rate loans are due to mature within the next three-year period through a combination of careful planning of new loans taken out and (where it is economic to do so) making early repayments.

### **Market risk**

#### **Interest rate risk**

The authority is exposed to significant risk in terms of its exposure to interest rate movements on its borrowings and investments. Movements in interest rates have a complex impact on the authority. For instance, a rise in interest rates would have the following effects:

- borrowings at variable rates – the interest expense charged to the Income and Expenditure Account will rise
- borrowings at fixed rates – the fair value of the liabilities borrowings will fall
- investments at variable rates – the interest income credited to the Income and Expenditure Account will rise
- investments at fixed rates – the fair value of the assets will fall.

Borrowings are not carried at fair value in the Council's accounts, so nominal gains and losses on fixed rate borrowings would not impact on the General Fund. However, changes in interest payable and receivable on variable rate borrowings and investments would impact on the General Fund.

The authority has a number of strategies for managing interest rate risk. Policy is to aim to keep a maximum of £0 of its net borrowings and investments in variable rate loans (i.e. variable rate borrowing will not exceed variable rate investments). During periods of falling interest rates, and where

economic circumstances make it favourable, fixed rate loans will be repaid early to limit exposure to losses. The risk of loss is ameliorated by the fact that a proportion of government grant payable on financing costs will normally move with prevailing interest rates or the authority's cost of borrowing and provide compensation for a proportion of any higher costs.

The treasury management team has an active strategy for assessing interest rate exposure that feeds into the setting of the annual budget and which is used to update the budget monitoring during the year. This allows any adverse changes to be accommodated. The analysis will also advise whether new borrowing taken out is fixed or variable.

### Price risk

The authority does not invest in equity shares and has no shareholdings. The authority is not consequently exposed to losses arising from movements in the prices of the shares.

## 6.10.4 Specified Investments

These investments are considered to be generally very secure in nature and do not require any lengthy evaluations before investing. A maximum of 100% of investments can be placed in this category.

(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 (Bank of England)	} Considered very secure	In-house
Term deposits – UK government		In-house
Term deposits – other LAs		In-house
Term deposits – banks and building societies up to 364 days*	}	In-house and fund managers
Term deposits – banks and building societies up to 6 months*		In-house
Callable Deposit	} Short-term F1+, Long-term AA-, Support 3,	In-house and fund managers
Callable Range Accrual		In-house and fund managers
Snowball		In-house and fund managers
Certificates of deposits issued by banks and building societies	}	Fund Managers
Money Market Funds		In-house and fund managers
Enhanced Cash Funds	}	In-house and fund managers
UK Government Gilts		Fund Managers
Bonds issued by multilateral development banks	} AAA	In-house on a 'buy and hold' basis and for use by fund managers
Bonds issued by a financial institution which is guaranteed by the UK government		In-house on a 'buy and hold' basis and for use by fund managers
Sovereign bond issues (i.e. other than the UK govt)		In-house on a 'buy and hold' basis and for use by fund managers
Gilt Funds and Bond Funds	long-term AAA	Fund Managers
Treasury Bills	Considered very secure	Fund Managers

### 6.10.5 Non-Specified Investments:

A maximum of 90% will be held in aggregate in non-specified investments. These are investments that require an evaluation and full consideration before investing.

	Minimum Credit Criteria	Use
Term deposits – UK government (with maturities in excess of 1 year)	} Considered very secure	In-house
Term deposits – other LAs (with maturities in excess of 1 year)		In-house
Term deposits – banks and building societies (with maturities in excess of 1 year)	} Short-term F1+, Long-term AA-, - Support 3, Individual C, Sovereign AA-	In-house
Certificates of deposits issued by banks and building societies		Fund managers
Callable Deposit		In-house and fund managers
Callable Range Accrual		In-house and fund managers
Snowball		In-house and fund managers
UK Government Gilts with maturities in excess of 1 year	AAA	Fund Managers
Bonds issued by multilateral development banks with maturities in excess of 1 year	AAA	In-house on a 'buy-and-hold' basis. Also for use by fund managers
Bonds issued by a financial institution which is guaranteed by the UK government with maturities in excess of 1 year	AAA	In-house on a 'buy-and-hold' basis. Also for use by fund managers
Sovereign bond issues (i.e. other than the UK govt)	AAA	Fund Managers
Corporate Bonds: <b><i>the use of these investments currently constitute capital expenditure and the Council will not utilise them whilst they do.</i></b>	* Long-term AA-,	Fund Managers
Floating Rate Notes: <b><i>the use of these investments would constitute capital expenditure and the Council will not utilise them whilst they do.</i></b>	* Long-term AA-,	Fund Managers
Property fund: <b><i>the use of these investments would constitute capital expenditure and the Council will not utilise them whilst they do</i></b>	Unrated	Fund Managers
Investments Schemes approved by the Trustee Investment Act 1961 – which includes the Local Authorities' Property Fund	Unrated	In House

### 6.10.6 Investment Strategy

**In-house funds:** Some of the Council's in house investments arise from cashflow but we do also have a holding of fixed investments and callable deposits. Investments will accordingly be made with reference to the core balances and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

The Council holds the following investments that span the end of the financial year

	Amount £m	Maturity	Rate
Alliance & Leicester	5.000	24/01/2011	5.52%
Royal Bank of Scotland	10.000	30/07/2012	Variable
Dexia	5.000	01/10/2013	6.62%
Royal Bank of Scotland	5.000	01/10/2013	6.80%
Barclays Bank	5.000	06/03/2014	6.31%
Barclays Bank	5.000	31/03/2014	6.37%
Barclays Bank	5.000	22/04/2014	6.35%
Barclays Bank	5.000	01/08/2014	6.32%
Total	45.000		

**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 2010 and then to rise steadily from thereon. Bank Rate forecasts for financial year ends (March) are as follows: -

- 2010 0.50%
- 2011 1.50%
- 2012 3.50%
- 2013 4.50%

There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected.

The Council will avoid locking into longer term investment deals while investment rates are down at historically low levels unless exceptionally attractive rates are available which make longer term deals worthwhile.

For 2010/11 it is suggested that the Council should budget for an investment return of 0.90% on investments placed during the financial year.

**Fund Manager's View on Interest Rates:** at the 31 December 2009 £40m of the Council's funds were externally managed on a discretionary basis by Investec and Invesco although £10m will be withdrawn during early 2010. Their view on interest rates and opportunities for gilts/bonds is as follows:

The fund managers feel that base rates will increase gradually during 2010/11, but with interest rates at such low levels the return on the portfolio will be between 1 and 2%. A pragmatic approach will be made to investments looking to exploit any opportunities in the market.

### **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.

#### **6.10.7 Policy on the use of external service providers**

The Council uses Sector Treasury Services 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.

#### **6.10.8 Scheme of delegation**

Please see Appendix 9

#### **6.10.9 Role of Section 151 Officer**

Please see Appendix 10

### **7.0 MRP STRATEGY**

The Council's MRP Strategy together with a commentary on what MRP is and how the new powers will operate are shown in Appendix 3. The Policy states that for historic debt and new supported borrowing MRP will continue to be assessed as 4% of the reducing balance. For prudential borrowing MRP will be charged to revenue based on the life of the asset, MRP will only become due once the asset is fully operational, it will also enable MRP holidays to be taken in relation to assets that will be temporarily funded by prudential borrowing in lieu of the capital receipt. The Budget Strategy relies on this in relation to a number of receipts as shown in the table below.

	2009/10 £m	2010/11 £m	2011/12 £m	2012/13 £m	Total £m
Railfreight	0.85	2.60			3.45
Wellington BTI			2.70	2.15	4.85
Old Park School			5.40		5.40
Leegomery				1.00	1.00
	0.85	2.60	8.10	3.15	14.70

This represents an exposure to future increased revenue charges should receipts not be delivered to these values or phasing and it is suggested this exposure should not be increased at present.

### **8.0 IMPLICATIONS**

## 8.1 Equal Opportunities

No implications

## 8.1 Environmental Impact

No impact

## 8.2 Legal Comment

The Annual Investment Strategy is required under the Guidance for Local Authority Investments issued by CLG.

## 8.3 Links with Corporate Priorities

A sound treasury management policy and strategy underpins the overall budget and resources of the Council.

## 8.4 Financial Implications

Where appropriate these are detailed in the body of the report.

## 8.5 Opportunities & Risks

The key opportunities and risks associated with treasury management activities are set out in the body of the report and will be regularly monitored throughout the year.

## 8.6 Ward Implications

District Wide Implications

## 9.0 **BACKGROUND PAPERS**

CIPFA Code of Practice for Treasury Management in Local Authorities  
Fund Manager Valuations  
Temporary Borrowing Records  
PWLB records  
Investment records  
Draft Treasury Strategy provided by Sector  
Local Government Act 2003  
CLG Guidance on Local Authority Investments

## Audit Commission – Risk and Return

For further information please contact:

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**SUMMARY OF INVESTMENTS AS AT 31 DECEMBER 2009**

	CREDIT RATING Sovereign	CREDIT RATING	INVESCO £'000's	%	INVESTEC £'000's	%	IN HOUSE	%	TOTAL £'000's	%
<b><u>FIXED TERM DEPOSITS</u></b>										
Alliance & Leicester	UK AAA	F1+AA- B 1					5,000		5,000	
Barclays	UK AAA	F1+AA- B 1					20,000		20,000	
Dexia	Belgium AA+	F1+A+ C/D 1					5,000		5,000	
HSBC	UK AAA	F1+AA B 1					1,850		1,850	
Royal bank of Scotland	UK AAA	F1+AA- D/E 1					5,000		5,000	
	<b>TOTAL</b>		<b>0</b>	<b>0.00</b>	<b>0</b>	<b>0.00</b>	<b>36,850</b>	<b>78.66</b>	<b>36,850</b>	<b>42.69</b>
<b><u>CD'S</u></b>										
Abbey National	UK AAA	F1+AA- B 1			902				902	
Banco Bilb	Spain AAA	F1+AA- A/B 1	1,899		2502				4,401	
Bank of Scotland	UK AAA	F1+AA- C 1	1,901						1,901	
Calyon	France AAA	F1+AA- C 1			1302				1,302	
CSFB	UK AAA	F1+AA- N/R 1			952				952	
Ing bank	Netherlands AAA	F1+A+ C 1	1,900						1,900	
Lloyds Bank	UK AAA	F1+AA- C 1			2,905				2,905	
Nationwide	UK AAA	F1+AA- B 1			2,905				2,905	
Nordea	Finland AAA	F1+AA- B 1	1,900		2,902				4,802	
Rabobank	Netherlands AAA	F1+AA+ A 1			800				800	
	<b>TOTAL</b>		<b>7,600</b>	<b>38.64</b>	<b>15,170</b>	<b>76.63</b>			<b>22,770</b>	<b>26.38</b>
<b><u>SUPRANATIONAL BONDS</u></b>										
European Invest Bank		F1+AAA	129		1,003				1,132	
	<b>TOTAL</b>		<b>129</b>	<b>0.66</b>	<b>1,003</b>	<b>5.07</b>			<b>1,132</b>	<b>1.31</b>
<b><u>UK GOVERNMENT TREASURY BILLS</u></b>										
UTD		AAA			3,597		18.17		3,597	4.17
<b><u>GILTS</u></b>	-		2,037	10.36			0.00		2,037	2.36
<b><u>CASH</u></b>	-		9,901	50.34	26		0.13		9,927	11.50
<b><u>CALLABLE DEPOSITS</u></b>										
The Royal Bank of Scot	UK AAA	F1+AA- D/E 1					10,000	21.34	10,000	11.59
	<b>TOTAL</b>		<b>19,667</b>	<b>100</b>	<b>19,796</b>	<b>100</b>	<b>46,850</b>	<b>100</b>	<b>86,313</b>	<b>100</b>

**TOTAL RISK PER COUNTERPARTY AS AT 31 DECEMBER 2009**

	<b>CREDIT RATING</b>		<b>TOTAL £'000'S</b>
Abbey National	UK AAA	F1+AA- B 1	902
Alliance & Leicester	UK AAA	F1+AA- B 1 F1+AA- A/B	5,000
Banco Bilb	Spain AAA	1	4,401
Bank of Scotland	UK AAA	F1+AA- C 1 F1+AA- B	1,901
Barclays	UK AAA	1 F1+AA- C	20,000
Calyon	France AAA	1	1,302
CSFB	UK AAA	F1+AA- N/R 1	952
Dexia	Belgium AA+	1	5,000
HSBC	UK AAA	F1+AA B 1	1,850
Ing bank	Netherlands AAA	F1+A+ C 1	1,900
Lloyds Bank	UK AAA	F1+AA- C 1 F1+AA- B	2,905
Nationwide	UK AAA	1	2,905
Nordea	Finland AAA	F1+AA- B 1	4,802
Rabobank	Netherlands AAA	F1+AA+ A 1	800
Royal bank of Scotland	UK AAA	F1+AA- D/E 1	15,000
<b>TOTAL- FIXED TERM AND CASH DEPOSITS</b>			69,620
UK Government Treasury Bills- Utd			3,597
Gilts			2,037
Cash			9,927
Supranational			1,132
<b>Total</b>			<b>86,313</b>

## **MINIMUM REVENUE PROVISION – an introduction**

### **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 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 Minimum Revenue Provision, which was previously determined under Regulation, and will in future be 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.”

The above is a substitution for the previous requirement to comply with regulation 28 in S.I. 2003 no. 3146, (as amended)

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 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.

The Council are 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.

### **Option 1: Regulatory Method**

Under the previous MRP regulations, MRP was set at a uniform rate of 4% of the adjusted CFR (i.e. adjusted for "Adjustment A") on a reducing balance method (which in effect meant that MRP charges would stretch into infinity). This historic approach must continue for all capital expenditure incurred in years before the start of this new approach. It may also be used for new capital expenditure up to the amount which is deemed to be supported through the Supported Capital Expenditure annual allocation..

### **Option 2: Capital Financing Requirement Method**

This is a variation on option 1 which is based upon a charge of 4% of the aggregate CFR without any adjustment for Adjustment A, or certain other factors which were brought into account under the previous statutory MRP calculation. The CFR is the measure of an authority's outstanding debt liability as depicted by their balance sheet.

### **Option 3: Asset Life Method.**

This method may be applied to most new capital expenditure, including where desired that which may alternatively continue to be treated under options 1 or 2.

Under this option, it is intended that MRP should be spread over the estimated useful life of either an asset created, or other purpose of the expenditure. There are two useful advantages of this option: -

- Longer life assets e.g. freehold land can be charged over a longer period than would arise under options 1 and 2.
- No MRP charges need to be made until the financial year after that in which an item of capital expenditure is fully incurred and, in the case of a new asset, comes into service use (this is often referred to as being an 'MRP holiday'). This is not available under options 1 and 2.

There are two methods of calculating charges under option 3:

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

### **Option 4: Depreciation Method**

Under this option, MRP charges are to be linked to the useful life of each type of asset using the standard accounting rules for depreciation (but with some exceptions) i.e. this is a more complex approach than option 3.

The same conditions apply regarding the date of completion of the new expenditure as apply under option 3.

#### **4. Date of implementation**

The previous statutory MRP requirements ceased to have effect after the 2006/07 financial year. However, the same basis of 4% charge may continue to be used without limit until the 2010/11 financial year, relative to expenditure incurred up to 31/3/2010.

In general it is recommended that authorities should adopt the recommendations contained within the guidance. However, in certain cases the guidance may recommend a useful life period/MRP for expenditure which it may not be considered appropriate to adopt. It is suggested that full details of MRP options/principles adopted should be set out and approved as part of the annual MRP Policy Statement.

The following is the Council's Policy Statement and was originally agreed by Council on 5/3/09.

## **MINIMUM REVENUE PROVISION POLICY STATEMENT 2010/11 (England and Wales)**

The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2007/08, and assess their MRP for 2007/08 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003. .

The major proportion of the MRP for 2007/08 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. As will expenditure funded from government borrowing approval which is in line with how that borrowing is supported through RSG. Certain expenditure reflected within the debt liability at 31 March 2007 will under delegated powers be subject to MRP under option 3 which 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. For example, capital expenditure on a new building, or on the refurbishment or enhancement of a building, will be related to the estimated life of that building. Under this method MRP will not be charged until an asset is fully complete and operational. This will also allow an MRP holiday in relation to schemes that are temporarily funded from prudential borrowing, but will ultimately be funded from capital receipts once realised.

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.

## **Economic Background**

### **Introduction**

The credit crunch storm of August 2007 eventually fed through to the near collapse of the world banking system in September 2008. This then pushed most of the major economies of the world into a very sharp recession in 2009 accompanied by a dearth of lending from banks anxious to rebuild their weakened balance sheets. Many governments were forced to recapitalise and rescue their major banks and central banks precipitately cut their central bank rates to 0.10 – 1.00% in order to counter the recession.

The long awaited start of growth eventually came in quarter 3 2009 in the US and the EU. However, there was disappointment that the UK failed to emerge from recession in quarter 3.

Inflation has plunged in most major economies and is currently not seen as being a problem for at least the next two years due to the large output gaps and high unemployment putting a lid on wage growth. In many countries there have been widespread pay freezes in 2009 and these are likely to be persistent for some time. Deflation could become a threat in some economies if they were to go into a significant double dip recession.

Asian countries, especially China, are buoying world demand through their own stimulus measures.

There still needs to be a radical world rebalancing of excess savings rates by cash rich Asian and oil based economies and excess consumption rates in Western economies if the world financial system is not to avoid a potential rerun of this major financial crisis in years to come.

Most major economies have resorted to a huge expansion of fiscal stimulus packages in order to encourage a fast exit from recession. This, together with expenditure on direct support provided to ailing banks, has led to a drastic expansion in government debt levels which will take many years to eliminate and to restore the previous health of national finances.

### **Two growth scenarios**

The current big issue is 'how quickly will the major world economies recover?' There is a sharp division of opinion on this question as set out below. The knock on effects on forecasts for interest rates can be seen in the main body of the report – UBS strong recovery, Capital Economics – weak recovery.

#### **Strong recovery**

This is a normal cyclical recovery which will be strong in the major world economies. The US still has potential to add further fiscal stimulus in 2010 to ensure that strong recovery continues after the current round of stimulus measures end. Growth in the EU is likely to be strong in 2010 and not require such help.

#### **The UK:**

GDP growth will almost get back to the long term average of about 2.5% in 2011 but is likely to peak in the first half of the year as inventory rebuilding and stimulus measures fade and fiscal contraction kicks in later in the year.

The economy will rebalance with strong growth in exports and import substitution helped by strong recovery in the EU and the rest of the world.

Sterling has depreciated by 25% since the peak in 2007 and is likely to stay weak.

Consumer spending – only a mediocre recovery is expected due to a steady increase in the savings ratio from +5.6% in 2009 to about 8% in 2011 as consumers

pay down debt or build cash balances. Consumer incomes will be held down by wage freezes and increases in taxation.

House price recovery is expected to persist helped by a low Bank Rate for a prolonged period; the peak to trough fall in house prices is now expected to be no more than 20%. House prices to rise by about 6% in 2010, and 3% in 2011; mortgage approvals will rise back to the level of 75 - 80,000 per month needed to ensure a continuation of a trend of rising house prices.

CPI inflation to peak @ 2.5% in early 2010 after the rise in VAT in January but then to fall to a trough near 1.5% in early 2011 and to stay below 2% for the rest of 2011. The current MPC attitude is one of hang on as long as possible before increasing Bank Rate. The aim of this would be to try to ensure that growth gets going at a decent rate and that Bank Rate gets back to 4 – 5% before the next recession and that all assets purchased through QE have been sold off by then. The first Bank Rate increase is expected in Q3 2009.

If a Conservative Government comes to power in 2010 with a more aggressive fiscal approach then this could delay the timing of Bank Rate starting to go up.

The fiscal deficit is 6.4% of GDP, about £90bn, which is expected to fall at £11bn p.a. over eight years at currently planned rates. This is similar to the peak deficit of 7% in 1990s which was remedied to a surplus of 1.6% in the space of 6 years helped by strong, steady economic growth of 3% p.a. supported by loose monetary policy that compensated for the fiscal squeeze.

Gilt yields, especially longer term ones, are currently artificially low due to the Bank of England's Quantitative Easing operations. £200bn of gilts, commercial bonds and paper are being purchased under this scheme which has inflated prices and depressed yields. Once this campaign ends, yields will inevitably rise but will also rise due to the huge level of issuance of new gilts to finance the fiscal deficit. Long gilt yields are therefore forecast to reach 6% during 2011.

Gilt yields could rise higher if there was a hung Parliament in 2010 or if the fiscal situation deteriorates further.

The major risk to this scenario would be a lack of supply of bank credit. However, it is felt that the Bank of England is on alert to ensure that this does not happen and would continue various measures to assist the expansion of credit.

#### Weak recovery

The current economic cycle is not a normal business cycle but a balance sheet driven cycle. Over borrowed banks, corporates and consumers are focused on shrinking their levels of borrowing to more viable and affordable levels and this balance sheet adjustment will take several years to be effected. Repayment of debt will therefore act as a major head wind to the required increase in demand in the economy. Consequently there will only be weak economic recovery over the next few years after the initial sharp inventory rebuilding rebound fades. GDP growth is forecast to reach only +1.5% in 2011.

Fiscal contraction will further dampen economic recovery driven by a strong political agenda to accelerate cuts in expenditure and increases in taxation after the general election in 2010.

The consumer savings ratio will rise so as to eliminate over borrowing and to insure against people losing their jobs during this downturn. This will depress consumer expenditure, the main driver of the UK economy.

Growth will also be hampered by a reduced supply of credit from weakened banks compounded by weak demand for credit.

The eventual reversal of Quantitative Easing will take cash out of the economy and reduce demand in the economy.

Unemployment is likely to rise to near to 3m in 2010 and take years to subside due to weak growth. High unemployment will reduce tax income and increase expenditure on benefits and the costs of local authority services. Inflation will not be a threat for several years as the current 6% output gap will take until 2014 to be eliminated.

However, deflation is a major danger for some years: the major falls in manufacturing prices over the last 12 -18 months have still to feed through to the economy and then to impact wage deflation.

CPI inflation will blip up over 2% in early 2010 but will then be on a strong downward trend to about -1% in 2011.

There is no need for the MPC to change Bank Rate from 0.5% in 2010 or 2011 and possibly for 5 years as they will need to counter the fiscal contraction which will dampen demand in the economy.

Long PWLB rates will FALL from current levels to near 4% in 2010 due to weak economic recovery and minimal inflation so that the real rate of return (net of inflation) on long gilts is healthy at these low levels

### Sector view

Sector recognises that at the current time it is difficult to have confidence as to exactly how strong the UK economic recovery will prove to be. Both the above scenarios are founded on major assumptions and research which could or could not turn out to be correct.

Sector has adopted a more moderate view between these two scenarios outlined above i.e. a moderate return to growth.

We do, however, feel that the risks that long term gilt yields and PWLB rates will rise markedly are high.

There are huge uncertainties in all forecasts due to the major difficulties of forecasting the following areas: -

- degree of speed and severity of fiscal contraction after the general election
- timing and amounts of the reversal of Quantitative Easing,
- speed of recovery of banks' profitability and balance sheet imbalances
- changes in the consumer savings ratio
- rebalancing of the UK economy towards exporting and substituting imports

The overall balance of risks is weighted to the downside i.e. the pace of economic growth disappoints and Bank Rate increases are delayed and / or lower

There is an identifiable risk of a double dip recession and deleveraging creating a downward spiral of falling demand, falling jobs and falling prices and wages leading to deflation but this is considered to be a small risk and an extreme view at the current time on the basis of current evidence.

## Credit Ratings – A Guide.

### *Long-term credit ratings and Sovereign Ratings*

Fitch Rating' long-term credit ratings are set up along a scale from 'AAA' to 'D', first introduced in 1924 and later adopted and licensed by Standard & Poors (S&P). Moody's also uses a similar scale, but names the categories differently. Like S&P, Fitch also uses intermediate modifiers for each category between AA and CCC (i.e., AA+, AA, AA-, A+, A, A-, BBB+, BBB, BBB- etc.).

### Investment grade

- **AAA** : the best quality, reliable and stable
- **AA** : good quality, a bit higher risk than AAA
- **A** : economic situation can affect finance
- **BBB** : medium class counterparties, which are satisfactory at the moment

### Non-investment grade

- **BB** : more prone to changes in the economy
- **B** : financial situation varies noticeably
- **CCC** : currently vulnerable and dependent on favorable economic conditions to meet its commitments
- **CC** : highly vulnerable, very speculative bonds
- **C** : highly vulnerable, perhaps in bankruptcy or in arrears but still continuing to pay out on obligations
- **D** : has defaulted on obligations and Fitch believes that it will generally default on most or all obligations
- **NR** : not publicly rated

### *Short-term credit ratings*

Fitch's short-term ratings indicate the potential level of default within a 12-month period.

- **F1+** : best quality grade, indicating exceptionally strong capacity of obligor to meet its financial commitment
- **F1** : best quality grade, indicating strong capacity of obligor to meet its financial commitment
- **F2** : good quality grade with satisfactory capacity of obligor to meet its financial commitment
- **F3** : fair quality grade with adequate capacity of obligor to meet its financial commitment but near term adverse conditions could impact the obligor's commitments
- **B** : of speculative nature and obligor has minimal capacity to meet its commitment and vulnerability to short term adverse changes in financial and economic conditions
- **C** : possibility of default is high and the financial commitment of the obligor are dependent upon sustained, favourable business and economic conditions
- **D** : the obligor is in default as it has failed on its financial commitments.

## **Bank Individual Ratings**

Individual Ratings are assigned to banks that are legal entities. The term "banks" here includes bank holding companies and bank assurance holding companies, bank assurance companies operating as single legal entities, investment banks and private banks. These ratings may also be assigned to leasing companies, instalment credit companies, credit card companies, brokerage houses, investment management companies and securities dealing companies, as circumstances demand. These ratings, which are internationally comparable, attempt to assess how a bank would be viewed if it were entirely independent and could not rely on external support. These ratings are designed to assess a bank's exposure to, appetite for, and management of risk, and thus represent the agency's view on the likelihood that it would run into significant financial difficulties such that it would require support.

- A:** A very strong bank. Characteristics may include outstanding profitability and balance sheet integrity, franchise, management, operating environment or prospects.
- B:** A strong bank. There are no major concerns regarding the bank. Characteristics may include strong profitability and balance sheet integrity, franchise, management, operating environment or prospects.
- C:** An adequate bank, which, however, possesses one or more troublesome aspects. There may be some concerns regarding its profitability and balance sheet integrity, franchise, management, operating environment or prospects.
- D:** A bank that has weaknesses of internal and/or external origin. There are concerns regarding its profitability and balance sheet integrity, franchise, management, operating environment or prospects. Banks in emerging markets are necessarily faced with a greater number of potential deficiencies of external origin.
- E:** A bank with very serious problems, which either requires or is likely to require external support.
- F:** A bank that has either defaulted or, in Fitch Ratings' opinion, would have defaulted if it had not received external support. Examples of such support include state or local government support, (deposit) insurance funds, acquisition by some other corporate entity or an injection of new funds from its shareholders or equivalent.

Notes: Gradations may be used among the ratings A to E: i.e. A/B, B/C, C/D, and D/E. No gradations apply to the F rating.

## **Support Ratings (1 – 5)**

### **The Purpose and Function of Support Ratings**

Support Ratings are Fitch Ratings' assessment of a potential supporter's propensity to support a bank and of its ability to support it. Its propensity to support is a

judgment made by Fitch Ratings. Its ability to support is set by the potential supporter's own Issuer Default Ratings, both in foreign currency and, where appropriate, in local currency. Support Ratings do not assess the intrinsic credit quality of a bank. Rather they communicate the agency's judgment on whether the bank would receive support should this become necessary. These ratings are exclusively the expression of Fitch Ratings' opinion even though the principles underlying them may have been discussed with the relevant supervisory authorities and/or owners.

### **Timeliness and Effectiveness Requirements**

Fitch Ratings' Support Rating definitions are predicated on the assumption that any necessary "support" is provided on a timely basis. The definitions are also predicated on the assumption that any necessary support will be sufficiently sustained so that the bank being supported is able to continue meeting its financial commitments until the crisis is over.

### **Obligations and Financial Instruments Covered**

In terms of these definitions, unless otherwise specified, "support" is deemed to be in terms of foreign currency. It is assumed that typically the following obligations will be supported: senior debt (secured and unsecured), including insured and uninsured deposits (retail, wholesale and interbank); obligations arising from derivatives transactions and from legally enforceable guarantees and indemnities, letters of credit, and acceptances; trade receivables and obligations arising from court judgments.

Likewise, the agency does not assume that the following capital instruments will be supported when sovereign support is involved: preference/preferred shares or stock; hybrid capital (tier 1 and upper tier 2), including reserve capital instruments (RCIs) and variations upon RCIs; and common/ordinary equity capital. It is also assumed that there will be no support for any moral obligation on securitizations. The sovereign support status of subordinated debt is difficult to categorize in advance; it is assessed on a case by case basis, distinguishing among different jurisdictions.

### **Definitions:**

- 1:** A bank for which there is an extremely high probability of external support. The potential provider of support is very highly rated in its own right and has a very high propensity to support the bank in question. This probability of support indicates a minimum Long-Term Rating floor of 'A-'.
- 2:** A bank for which there is a high probability of external support. The potential provider of support is highly rated in its own right and has a high propensity to provide support to the bank in question. This probability of support indicates a minimum Long-Term Rating floor of 'BBB-'.
- 3:** A bank for which there is a moderate probability of support because of uncertainties about the ability or propensity of the potential provider of support to do so. This probability of support indicates a minimum Long-Term Rating floor of 'BB-'.

- 4:** A bank for which there is a limited probability of support because of significant uncertainties about the ability or propensity of any possible provider of support to do so. This probability of support indicates a minimum Long-Term Rating floor of 'B'.
  
- 5:** A bank for which external support, although possible, cannot be relied upon. This may be due to a lack of propensity to provide support or to very weak financial ability to do so. This probability of support indicates a Long-Term Rating floor no higher than 'B-' and in many cases no floor at all.

**GLOSSARY**

<b>Term</b>	<b>Meaning</b>
Affordable Borrowing Limit	The amount the authority would normally borrow at any point of time in the year. This boundary might be exceeded temporarily but only in exceptional circumstances. The limit is set by Full Council at the beginning of March and is a prudential indicator.
Authorised Borrowing Limit	The maximum amount the authority can borrow at any point of time in the year. This limit should never be exceeded. The limit is set by Full Council at the beginning of March and is a prudential indicator.
Capital Financing Requirement (CFR)	This represents the underlying need for the authority to borrow and represent the assets of the authority less the long term capital liabilities.
Credit Default Swaps (CDS)	CDS are bought by investors to insure against defaults (i.e. the counterparty not being able to repay). The higher the cost/premium then the higher the risk – CDS therefore given a market view of the credit worthiness of an organisation.
Credit Ratings	Rating on the ability of an organisation to meet its obligations; ratings are assigned by independent, specialist companies, such as Fitch and Moodys using market intelligence they gather.
Credit Risk	The risk that the debtor will default on their obligations
Counterparty	The organisation that your are conducting your business with.
Debt Management Account Deposit Facility	Provided by the <a href="#">Debt Management Office</a> , users can place cash in secure fixed-term deposits. Deposits are guaranteed by the government and therefore have the equivalent of a sovereign triple-A credit rating.
Discounts	These relate to Public Works Loans Board loans. If rates have increased since the borrowing was undertaken then part of the benefit that PWLB will achieve from being able to loan out at that higher rate are passed back to an authority if they repay the loan early.
Fund Managers	Independent investment managers who

	work to a specific mandate and invest funds on behalf of the Council
Inflation	The rise in prices of goods and services over a period of time.
Interest Rate Risk	The risk that the value of an investment will change due to changes to the interest rate.
Internal Borrowing	This is where the amount of an authority's borrowing is less than its CFR or underlying need to borrow and represents the use of internal balances rather than borrowing from the market.
LIBID	London inter-bank bid rate. Interest rate at which prime banks will <b>borrow</b> money in the London inter-bank market.
LIBOR	London inter-bank offer rate. Interest rate at which prime banks will <b>lend</b> money in the London inter-bank market. Fixed every day by the British Bankers Association to five decimal places.
Liquidity Risk	The risk of not being able to trade an investment quickly to release cash.
Obligor	An individual or company that owes debt to another individual or company (the creditor), as a result of borrowing or issuing bonds.
Premia	This is the penalty applied to the early redemption of PWLB loans where rates have fallen since the loan was undertaken.
Prudential Code	A professional code of practice which provides regulatory framework to local authorities on capital expenditure, investments and borrowing activities.
Prudential Indicators	A set of indicators developed within the Prudential Code which define thresholds for investment and borrowing within a local authority.
PWLB	Public Works Loans Board – a Government agency providing long and short term loans to local authorities. Interest rates are generally lower than the private sector and slightly higher than the rates at which the Government themselves may borrow.
Re-scheduling	This relates to repaying existing borrowing early and replacing it with borrowing for a different period usually, but not necessarily, at lower rates
Return	The gain from holding an investment over a given period

Security	An investment instrument, other than an insurance policy or fixed annuity, issued by a corporation, government or other organisation which offers evidence of debt or equity.
Sovereign Exposure	Risk of exposure to one particular country.
Supranational Bonds	These are bonds (similar to gilts) issued by multi government development organisations and are supported by all of the governments who form part of the organisation. E.g European Investment Bank and are usually very secure.
Quantative Easing	This is where the government buy back there own gilt issuance to effectively pump money into the financial markets of the economy.

## **Treasury Management Policy Statement**

1. This organisation defines its treasury management activities as: “The management of the 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”.
2. This organisation 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.
3. This organisation 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 value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.”

## Adoption of the revised CIPFA Treasury Management Code of Practice 2009

### INTRODUCTION

The CIPFA Code of Practice on Treasury Management in Local Authorities was last updated in 2001 and has been revised in 2009 in the light of the default by Icelandic banks in 2008. The revised Code requires that a report be submitted to the council, board or other appropriate body, setting out four amended clauses which should be formally passed in order to approve adoption of the new version of the Code of Practice and Cross-Sectoral Guidance Notes.

The revised Code also includes an amended version of the treasury management policy statement (TMPS) incorporating just three clauses and a revised definition of treasury management activities. The Code does not require this statement to be approved by the council, board or other appropriate body.

The revised Code has also set out various requirements which have been summarised in paragraph 1 of the latest Treasury Management Strategy Statement.

### RESOLUTIONS

CIPFA recommends that all public service organisations adopt, as part of their standing orders, financial regulations, or other formal policy documents appropriate to their circumstances, the following four clauses.

1. This organisation will create and maintain, as the cornerstones for effective treasury management:
  - a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities
  - suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The content of the policy statement and TMPs 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.

2. This organisation (i.e. full board/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, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.

3. This organisation delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Audit Committee, and for the execution and administration of treasury management decisions to the Chief Finance Officer, who will act in accordance with the organisation's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

4. This organisation nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

## Treasury management scheme of delegation

### **(i) Full council**

- receiving and reviewing reports on treasury management policies, practices and activities
- approval of annual strategy.
- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices
- budget consideration and approval
- approval of the division of responsibilities

### **(ii) Cabinet**

- receiving and reviewing regular monitoring reports and acting on recommendations

### **(iii) Audit Committee**

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

### **(iv) Chief Finance Officer**

- approving the selection of external service providers and agreeing terms of appointment.

## The treasury management role of the section 151 officer

### **The S151 (responsible) 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
- recommending the appointment of external service providers.