ITEM **ITEM**

Executive – 21 January 2010

TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2010/11

Report of the Head of Financial Services

Statutory Powers: Local Government Act 2003

Financial Implications: Interest from our investments is estimated to amount to £375,000 in 2010/11.

Purpose: To advise Members of the Council's Treasury Management Strategy and to consider the prudential indicators and limits set out within the report, in accordance with the Prudential Framework. Consideration of this item relates to CP6 – "Improve core service performance in a cost effective way".

RECOMMENDATIONS:

That the Executive RECOMMENDS to Council to:

(i) approve the Treasury Management Strategy Statement and Annual Investment Strategy for 2010/11; and

(ii) adopt the revised CIPFA Treasury Management Code of Practice 2009.

Introduction

The Revised CIPFA Treasury Management Code of Practice 2009

1. 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 all Councils should formally adopt the Code which was reported to the Executive at its meeting on 7 January 2010.

2. 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, in our case to the Audit Committee;

(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).

3. 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 review by Members in both Executive and Audit Committee 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.

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

Area of Responsibility	**Council/Committee/ Officer**	**Frequency**
Treasury Management Policy Statement (revised)	Full council	Initial adoption in 2010
Treasury Management Strategy/Annual Investment Strategy	Full council	Annually before the start of the year
Treasury Management Strategy/Annual Investment	Full council	Mid year

Strategy – mid year report		
Treasury Management Strategy/Annual Investment Strategy – 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 Reports	Executive	Mid year
Scrutiny of Treasury Management Strategy	Audit Committee	Annually
Scrutiny of Treasury Management performance	Audit Committee	As required

Revised CIPFA Prudential Code

5. 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

6. 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.

Revised Investment Guidance

7. 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.

Treasury Management Strategy for 2010/11

8. 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.

9. 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); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

10. 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.

11. The strategy covers:

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

Balanced Budget Requirement

12. 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:

    (a) increases in interest charges caused by increased borrowing to finance additional capital expenditure; and

    (b) 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.

Treasury Limits for 2010/11 to 2012/13

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

14. The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains

within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is ‘acceptable’.

15. 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, details of the Authorised Limit can be found in appendix 3 of this report.

Prudential and Treasury Indicators for 2010/11 – 2012/13

16. Prudential and Treasury Indicators as set out in Appendix 3 to this report are relevant for the purposes of setting an integrated treasury management strategy.

Prospects for Interest Rates

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

Sector Bank Rate forecast for financial year ends (March)

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

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

Borrowing Strategy

19. It is anticipated that there will be no capital borrowings required during 2010/11.

Annual Investment Strategy

Investment Policy

20. 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.

21. 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.

22. 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.

23. Investment instruments and counterparty limits identified for use in the financial year are listed in Appendix 5 under the ‘Specified’ and ‘Non-Specified’ Investments categories laid down by Government regulations. Specified investments have a maturity of less than one year, whereas non specified investments can be made for periods of more than one year and will therefore be subject to more risk.

Creditworthiness Policy

24. 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
    - Credit Default Swaps(CDS) spreads to give early warning of likely changes in credit ratings
    - sovereign ratings to select counterparties from only the most creditworthy countries

25. 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.

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

Purple	1 year
Blue	6 months (only applies to nationalised or semi nationalised UK Banks)
Orange	6 months
Red	3 months
Green	1 month
No Colour	not to be used

27. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

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

- In addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list

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

29. **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%

30. There is a risk that interest rates may be lower than these forecasts if recovery from the recession proves to be weaker and slower than currently expected.

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

32. For 2010/11 the Council has budgeted for an average investment return of 0.50% on investments placed during the financial year.

Country limits

33. The Council will only use UK registered banks with the exception of the Banco Santander Central Hispano Banking Group which is a Spanish registered bank so long as it meets the minimum lending criteria set by the Council.

Investment Strategy

34. The Council manages its investments in-house and Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

35. The Council has the following investments that span the financial year:

	Amount	Maturity	Rate
Chelsea BS	5,000,000	30.07.10	6.18%
Skipton BS	2,500,000	01.09.10	5.78%
Coventry BS	2,500,000	23.07.11	6.15%

End of year investment report

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

Policy on the use of external service providers

37. The Council uses Sector Treasury Services as its external treasury management advisers.

38. 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.

39. 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.

Scheme of Delegation and Role of the Section 151 Officer

40. Please see appendices 8 and 9.

Risk Assessment

Opportunities/Benefits	
Consideration of the Annual Treasury Report forms an essential component of the Council's systems for public accountability. It also provides a platform for future investment planning.	
Issues/Obstacles/Threats	***Control measures / Mitigation***
• risk of failure of counterparty • advancing monies to the wrong counterparty • failure to make advance when contracted to do so • liquidity constraints affecting interest rate performance • volatility of interest rates / inflation • day to day management fault resulting in overdrawn above agreed limits	The Council has adopted the CIPFA Code Of Practice for Treasury Management and produces an annual Treasury Management Strategy and Investment Strategy in accordance with ODPM guidelines. The Council employs a Treasury Management advisor and a prudent view is always taken regarding future interest rate movements. Investment interest income is reported monthly to SMT and quarterly to the Executive.

John Foxworthy
Head of Financial Services

Executive
21 January 2010

Background papers:
None

APPENDIX 1

Minimum Revenue Provision

1. What is a Minimum Revenue Provision?

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

New 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) which prescribed how the MRP should be calculated in a prescribed manner.

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 CFR is the measure of an authority's outstanding debt liability as depicted by their balance sheet.

As the Council does not have any borrowing and has a negative CFR then there is no requirement to calculate the MRP.

APPENDIX 2

Interest Rate Forecasts

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

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

1. INDIVIDUAL FORECASTS

Sector interest rate forecast – 23.11.09

	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
Bank rate	0.50%	0.50%	0.75%	1.00%	1.50%	2.25%	2.75%	3.25%	3.50%	3.75%	4.25%	4.25%	4.50%
5yr PWLB rate	3.05%	3.20%	3.30%	3.40%	3.60%	3.85%	4.15%	4.55%	4.60%	4.80%	4.80%	4.85%	4.85%
10yr PWLB rate	4.00%	4.05%	4.15%	4.30%	4.45%	4.60%	4.80%	4.90%	5.00%	5.10%	5.10%	5.15%	5.15%
25yr PWLB rate	4.55%	4.65%	4.70%	4.80%	4.90%	5.00%	5.05%	5.10%	5.20%	5.30%	5.30%	5.35%	5.35%
50yr PWLB rate	4.60%	4.70%	4.75%	4.90%	5.00%	5.10%	5.15%	5.20%	5.30%	5.40%	5.40%	5.45%	5.45%

Capital Economics interest rate forecast – 5.11.09

	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
5yr PWLB rate	2.65%	2.15%	2.15%	2.15%	2.15%	2.15%	2.15%	2.15%
10yr PWLB rate	3.15%	2.65%	2.65%	2.65%	2.65%	2.65%	2.65%	2.65%
25yr PWLB rate	3.95%	3.75%	3.75%	3.75%	3.75%	3.75%	3.75%	3.75%
50yr PWLB rate	4.15%	4.05%	4.05%	4.05%	4.05%	4.05%	4.05%	4.05%

UBS interest rate forecast (for quarter ends) – 30.10.09

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

2. SURVEY OF ECONOMIC FORECASTS

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

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

APPENDIX 3

Prudential and Treasury Indicators

PRUDENTIAL INDICATORS	**2008/09**	**2009/10**	**2010/11**	**2011/12**	**2012/13**
Extract from budget and rent setting report	**actual**	**probable outturn**	**estimate**	**estimate**	**estimate**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Capital Expenditure	£3,332	£4,525	£2,793	£834	£2,585
Ratio of financing costs to net revenue stream	-13%	-7%	-4%	-3%	-3%
Net borrowing requirement	nil	nil	nil	nil	nil
Capital Financing Requirement as at 31 March	-£98	-£98	-£98	-£98	-£98
Annual change in Cap. Financing Requirement	£0	£0	£0	£0	£0
Future Incremental impact of capital investment decisions			**£ p**	**£ p**	**£ p**
Increase in council tax (band D) per annum			£0.62	£.018	£0.68

TREASURY MANAGEMENT INDICATORS	**2008/09**	**2009/10**	**2010/11**	**2011/12**	**2012/13**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Authorised Limit for external debt -					
borrowing	£4.5m	£4.5m	£5m	£5m	£5m
other long term liabilities	£0	£0	£1m	£1m	£1m
TOTAL	£4.5m	£4.5m	£6m	£6m	£6m
Operational Boundary for external debt -					
borrowing	£0.5m	£0.5m	£1m	£1m	£1m
other long term liabilities	£0	£0	£1m	£1m	£1m
TOTAL	£0.5m	£0.5m	£2m	£2m	£2m
Actual external debt	£0	£0	£0	£0	£0
Upper limit for fixed interest rate exposure					
Net principal re fixed rate investments	100%	100%	100%	100%	100%

Upper limit for variable rate exposure					
Net principal re variable rate investments	50%	50%	50%	50%	50%
Upper limit for total principal sums invested for over 364 days					
(per maturity date)	£10m	£10m	£10m	£10m	£10m

APPENDIX 4

Economic Background

4.1 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.

4.2 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 appendix 2 – UBS strong recovery, Capital Economics – weak recovery.

4.2.1 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.
- Consumer Price 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 Monetary Policy Committee 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 Quantitative Easing have been sold off by then. The first Bank Rate increase is expected in Q3 2009.
- If there is a change of Government in 2010 with a more aggressive fiscal approach then this could delay the timing of Bank Rate starting to go up.
- 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.

4.2.2 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.

- 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 <u>FALL</u> 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

4.2.3 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 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

APPENDIX 5

Specified Investments

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

	Minimum Credit Criteria
Debt Management Office Deposit Facility	n/a
UK Government Gilts	n/a
Term deposits – other Local Authorities and Police, Fire and National Park Authorities	n/a
Deposits - Money Market Funds and Government Liquidity Funds	AAA
Call deposits (instant notice) and term deposits – UK banks and building societies	See schedule Annex A
Lending to Nationalised/Part Nationalised Banks where the individual ratings of any of those Institutions has fallen below the normal minimum criteria	See schedule Annex A
Non UK bank – Banco Santander Central Hispano Bank (Spanish)	See schedule Annex A

Non Specified Investments

	Minimum Credit Criteria	A. Why use it B. Associated Risks
Term deposits – other Local Authorities and Police, Fire and National Park Authorities (with maturities in excess of 1 year)	n/a	A. Certainty of rate of return over period invested. No movement in capital value of deposit despite changes in interest rate movement. B. Illiquid; as a general rule, cannot be traded or repaid prior to maturity. Return will be lower if interest rates rise after making the investment. Credit risk; Very low.
Term deposits – UK banks and building societies	See schedule Annex A	A. Certainty of rate of return over period invested. No movement in capital value of deposit despite changes in interest rate movement. B. Illiquid; as a general rule, cannot be traded or repaid prior to maturity. Return will be lower if interest rates rise after making the investment.
Deposits - Money Market Funds and Government Liquidity Funds	AAA	A. AAA rated and daily access. Diversification of assets means that risks are lower. B. There is a possibility of capital fluctuations due to the nature of the underlying investments but this is minimised by the structure of the fund.
UK Government Gilts	n/a	A. Low risk Government backed. Liquid as they can be traded B. There is a possibility of capital fluctuations.

ANNEX A - Treasury Management Counterparty list

Lending up to 1 Year (from date of deposit)

Based on Fitch Ratings
Short Term rating of F1+
Long term rating: AAA, AA+, AA, AA-

Individual	Support			
	1	2	3	4
A	orange	orange	Green	
A/B	orange	orange	Green	
B	orange	orange	Green	
B/C				
C				
C/D				
D				

orange	Green
up to 6 months	up to 1 month
£4,000,000	£4,000,000

Based on Fitch Ratings
Short Term rating of F1+
Long term rating: AAA, AA+, AA

Individual	Support			
	1	2	3	4
A	purple	purple		
A/B	purple	purple		
B	purple	purple		
B/C				
C				
C/D				
D				

purple
up to 1 year
£4,000,000

UK Nationalised/Part Nationalised Banks

Based on Fitch Ratings

Lending to Nationalised/Part Nationalised Banks where the individual ratings of any of those Institutions has fallen below the normal minimum criteria

Sovereign Rating AAA

up to 6 months	£4,000,000	blue

Sector now use a colour coded matrix for the duration of a deposit. The advice is still based on bank long and short term credit ratings but enhanced by a number of other criteria which are explained below:

Support rating – judgement of a potential supporter (either a sovereign state's or an institutional owner's) propensity to support a bank and of its ability to support it. Its ability to support is set by the potential supporter's own Fitch long term debt rating, both in foreign currency and, where appropriate, in local currency. Support ratings have a direct link to long term debt ratings, but they do not assess the intrinsic credit quality of a bank. Rather they communicate Fitch ratings, judgement on whether the bank would receive support should this become necessary.

Individual rating – 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 banks' exposure to, appetite for, and management of risk, and thus represent the likelihood that it would run into significant difficulties such that it would require support.

Credit Default Swap – The above data is then overlaid with information from something known as the Credit Default Swap market. At its simplest a Credit Default Swap (CDS) is a cost of insuring debt against default. The more risky an institution is the higher the cost of insurance. There is a market for the CDS's and traders can profit from the changes in credit quality of institutions which is a useful way of predicting those banks which are under pressure.

Sector has set a range of parameters for benchmarking CDS data and assesses individual banks as; in range; monitoring; out of range. If a bank is 'in range' then the credit assessment colour remains unchanged; if the bank is 'being monitored' it means that the risk is higher and therefore the credit assessment is changed to a lower status; if the bank is 'out of range' the bank is deemed to be to risky too invest with.

APPENDIX 6

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."

APPENDIX 7

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 financial regulations 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 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 the Executive, and for the execution and administration of treasury management decisions to the Head of Finance, 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 Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

APPENDIX 8

Treasury Management Scheme of Delegation

(i) Full Council

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

(ii) Executive

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement for recommendation to Council
- budget consideration and approval
- approval of the division of responsibilities
- receiving and reviewing monitoring reports and acting on recommendations

(iii) Audit Committee

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

APPENDIX 9

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.