East Northamptonshire Council

Finance Sub Committee - 15 February 2010

Treasury Management Strategy Statement and Investment Strategy

Summary

The purpose of this report is to approve the Council's Treasury Management Strategy Statement and Investment Strategy (TMSS).

Attachment(s)

Treasury Management Strategy Statement and Investment Strategy

1. The CIPFA Code of Practice on Treasury Management, adopted by the Council in April 2002 requires the preparation of an annual Treasury Management Strategy Statement (TMSS). The 2003 Prudential Code for Capital Finance in Local Authorities introduced new requirements on how capital spending plans should be considered and approved and the development of an integrated treasury management strategy.

2. The Prudential Code requires the Council to set a number of Prudential Indicators, which replace the borrowing/variable interest limits previously determined as part of the Strategy Statement and also extend the period covered from one to three years. The report incorporates the Indicators which should be considered when determining the Council's Treasury Management Strategy for the next three financial years.

3. The Treasury Management Strategy from 2010/11 to 2012/13 needs to consider the following four matters:
   - The institutions the Council will invest money with
   - The types of investment instruments that will be used
   - The limits that are placed on either the institution or the instrument used
   - The underlying economic environment that will affect the types of investment the Council will use and the duration of these investments.

4. The format and content of the TMSS is determined by the CIPFA Code of Practice on Treasury Management.

5. Recommendation

That the Treasury Management Strategy Statement (TMSS) and Investment Strategy from 2010/11 to 2012/13 be approved and specifically: -

(i) the prudential Indicators in Appendix A of the TMSS be recommended to Council for approval;

(ii) the Council's MRP Strategy in section 5 of the TMSS be agreed;

(iii) the types of investment the Council can use in Appendix C be approved; and

(iv) the criteria for assessing the suitability of investment counterparties in Appendix D be agreed.

Implications:
Corporate Outcomes or Other Policy/Priority/Strategy

Good Quality of Life	☐	Good Reputation	☐
Good Value for Money	☐	High Quality Service Delivery	☐
Effective Partnership Working	☐	Strong Community Leadership	☐
Effective Management	☒	Knowledge of our Customers and Communities	☐
Employees and Members with the Right Knowledge, Skills and Behaviours			☐
Other:			☐
Decision(s) would be outside the budget or policy framework and require full Council approval			☐

Financial	There are no financial implications at this stage	☒
	There will be financial implications – see paragraph	☐
	There is provision within existing budget	☐
	Decisions may give rise to additional expenditure at a later date	☐
	Decisions may have potential for income generation	☐
Risk Management	An assessment has been carried out and there are no material risks	☐
	Material risks exist and these are recorded at Risk Register Reference – 218 & 526 inherent risk score - Primary residual risk score - Contingency	☒
Staff	There are no additional staffing implications	☒
	Additional staff will be required – see paragraph	☐
Equalities and Human Rights	There will be no impact on equality (race, age, gender, disability, religion/belief, sexual orientation) or human rights implications	☒
	There will be an impact on equality (see categories above) or human rights implications – see paragraph	☐
Legal	Power: Local Government Acts 1989 and 2003	
	Other considerations: CIPFA Code of Practice for Treasury Management The Prudential Code for Capital Finance in Local Authorities	

Background Papers:					
Person Originating Report: Robert Austin, Head of Resources					
Date: 18 January 2010					
CFO		**MO**		**CX**	

(Committee Report Normal Rev. 19)

Appendix 1

East Northamptonshire Council
Treasury Management Strategy Statement and Investment Strategy 2010/11 to 2012/13

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Appendices

1. Background

1.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") requires local authorities to set the Treasury Management Strategy Statement (TMSS) for borrowing each financial year.

1.2 CIPFA has defined Treasury Management as:

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

1.3 In response to the financial crisis in 2008 and the collapse of the Icelandic banks, CIPFA revised the TM Code and Guidance Notes as well as the Prudential Indicators in late November 2009. The Department for Communities and Local Government (CLG) is also in the process of revising and updating the Investment Guidance. Changes required to be made to this Strategy and/or documentation will be placed before Members for consideration at the next appropriate meeting.

1.4. The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Treasury management risks are identified in the Council's approved Treasury Management Practices; the main risks to the Council's treasury activities are:

- Liquidity Risk (Inadequate cash resources)
- Market or Interest Rate Risk (Fluctuations in interest rate levels and thereby in the value of investments).
- Inflation Risks (Exposure to inflation)
- Credit and Counterparty Risk (Security of Investments)
- Refinancing Risks (Impact of debt maturing in future years).
- Legal & Regulatory Risk (i.e. non-compliance with statutory and regulatory requirements, risk of fraud).

1.4 The purpose of this Treasury Management Strategy Statement is to approve:

- Treasury Management Strategy for 2010-11
- Prudential Indicators – Appendix A
- MRP Strategy – Section 5
- Use of Specified and Non-Specified Investments – Appendix C
- Criteria for accepting counterparties on to the Council's approved lending list – Appendix D

2. The Treasury Position

2.1 The Council's estimated treasury position for 31/3/2010 and for the following financial years is:

	31/3/2010 Estimate £m	% Return	31/3/2011 Estimate £m	31/3/2012 Estimate £m	31/3/2013 Estimate £m
Investments:					
Short-term deposits	8.0	1.07	11.3	10.6	13.2
Long-term deposits	4.0	6.53	0.0	0.0	0.0
Total Investments	12.0	2.89	11.3	10.6	13.2

2.2 The estimate for interest receipts in 2009/10 is £0.5m. The estimates for 2010/11 and subsequent years take into consideration the current portfolio and the outlook for interest rates. It should be noted that the long term deposits that bolster our investment return will mature during 2010/11 and are likely to be invested at a much lower rate. The impact on interest earned has though been reflected in our financial plans.

3. Outlook for the Economy and Interest Rates

3.1 The economic interest rate outlook provided by the Council's treasury advisor, Arlingclose Ltd, is attached at Appendix B. It is summarised below.

3.2. **Background** – the two main factors affecting the economy and therefore interest rates during the current year were the "Credit Crunch" and recession. The credit crunch in essence related to the unwillingness of banks to lend to each other, to business and to individuals. This reluctance came about primarily because of the implications of the large scale American mortgage defaults (often referred to as sub-prime mortgages) and the impact this had on the stability of financial institutions worldwide.

3.3. The Government responded to the credit crunch issues by injecting cash into the banking sector and in some instances this involved taking a controlling share of the banks themselves. These actions prevented the failure of the major UK based banks however globally some banks went bust. The most notable of these for local authorities was the failure of the Icelandic banks.

3.4. As a significant amount of consumer spending relied on the availability of credit, the reluctance of banks to lend (or to lend at the previous advantageous rates) had an effect on the economy. Sales fell and throughout most of 2009 the economy was officially in recession (recession being two consecutive quarters of negative growth). Matters were compounded by the failure of a number of high profile UK companies and the laying off of significant numbers of employees from others. This only compounded the problems being faced by the economy. Again the Government has intervened with a number of measures intended to stimulate the economy. Interest rates fell to 0.5% and a programme of quantitative easing injected £200bn of cash into the banking system in an attempt to get it moving.

3.5. **Outlook –** the outlook for 2010 is slightly more rosy than that predicted last year. Christmas sales buoyed the figures for retailers and as a result it is expected that the move towards positive growth (and out of recession) may have occurred during the last quarter of 2009.

3.6. However, the national finances are in a dire state as a £170bn deficit is projected. Moving back towards a balanced budget position will be a delicate balancing act. Too fast and the resulting cut in public spending/increase in taxes will stifle spending and throw the country back into recession. Too slow and there is a real risk that the countries currently lending to the UK (by buying the gilts issued by the Government) could either stop or require a higher rate of return.

3.7. As such, the overriding view is that interest rates will remain at 0.5% until at least December 2010 when they are expected to start rising. The speed at which they rise will be dependent on the effectiveness of the economic policies implemented to date and any revised budget following the general election.

3.8. The investment rates that are available will differ slightly and these will start to anticipate rises to the base rate. As such the level the Council can invest money at is expected to be higher than the forecast for the base rate.

3.9. Based on the above outlook for interest rates, and after taking into consideration the existing position of our portfolio, it is anticipated that the average return on the Council's funds for the next four years will be;

Year	Average Return
2010/11	1.75
2011/12	3.00
2012/13	4.00
2013/14	5.00

4. Borrowing Requirement and Strategy

4.1 The Council's underlying need to borrow for capital purposes is measured by reference to its Capital Financing Requirement (CFR) – see Appendix A, section 4. The CFR represents the cumulative capital expenditure of the local authority that has not been financed (the underlying need to borrow). To ensure that this expenditure will ultimately be financed, local authorities are required to make a Minimum Revenue Provision for Debt Redemption (MRP) from within the Revenue budget each year.

4.2 Capital expenditure not financed from internal resources (i.e. Capital Receipts, Capital Grants and Contributions, Revenue or Reserves) will produce an increase in the CFR and in turn produce an increased requirement to charge MRP in the Revenue Account.

4.3 Physical external borrowing may be greater or less than the CFR, but in accordance with the Prudential Code, the Council will ensure that net external borrowing does not, except in the short term, exceed the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years.

4.4 The Council's strategy is to maintain maximum control over its borrowing activities as well as flexibility on its loans portfolio. Capital expenditure levels, market conditions and interest rate levels will be monitored during the year in order to minimise borrowing costs over the medium to longer term. A prudent and pragmatic approach to borrowing will be maintained to minimise borrowing costs without compromising the longer-term stability of the portfolio, consistent with the Council's Prudential Indicators.

4.5 In conjunction with advice from its treasury advisor, the Council will keep under review the options it has in borrowing from the PWLB, the market and other sources identified in the Treasury Management Practices Schedules up to the available capacity within its CFR and Affordable Borrowing Limit (defined by CIPFA as the Authorised Limit).

5. Annual MRP Statement

5.1 Draft Regulations produced by the Department for Communities and Local Government in November 2007 include draft consultation Guidance on Minimum Revenue Provision issued by the Secretary of State under section 21(1A) of the Local Government Act 2003. This Guidance includes a recommendation that before the start of each financial year a local authority prepares a statement of its policy on making MRP in respect of that financial year and submits it to the full Council. The statement should indicate which of the four options set out in the Guidance are to be followed in the financial year.

5.2 The four options available are set out below:
Option 1: Regulatory Method
Option 2: CFR Method
Option 3: Asset Life Method
Option 4: Depreciation Method

5.3. The regulatory method and CFR method are based on a technical calculation which assesses, with reference to the balance sheet, the need to borrow. MRP is then calculated at 4% of this amount. The asset life and depreciation method allow you to calculate MRP based on the life of the asset you are borrowing against.

5.4. The Council's CFR at 31 March 2010 is estimated to be £Nil/Negative and as such under Option 2 (the CFR Method) there is no requirement to charge MRP in 2010/11.

6. Investment Policy and Strategy

6.1. Background

6.1.1. Guidance from the then ODPM (Office of the Deputy Prime Minister, now CLG) on Local Government Investments in England requires that an Annual Investment Strategy (AIS) be set. The Guidance permits the Treasury Management Strategy Statement (TMSS) and the AIS to be combined into one document.

6.2. Investment Policy

6.2.1. The Council's general policy objective is to invest its surplus funds prudently. In previous years one of the priorities of the Council's investment policy concerned the investment yield received. Due to the current banking crisis which has seen institutions fold, it is now felt more appropriate to focus on the safe return of the sum invested. As such the Council's investment priorities in priority order are:

- security of the invested capital;
- liquidity of the invested capital;
- the return received from the investment.

The speculative procedure of borrowing purely in order to invest is unlawful and will not be used.

6.2.2. Investments are categorised as 'Specified' or 'Non Specified' investments based on the criteria in the ODPM Guidance. Potential instruments for the Council's use within its investment strategy are contained in Appendix C.

6.2.3. The Council will maintain a counterparty list based on its criteria and monitor and update the credit standing of the institutions on a regular basis. The events of 2008 have shown that it is no longer possible to rely on credit ratings and as such the Council will also take on board the advice and guidance of its advisors, Arlingclose, when determining with whom to invest. Appendix D sets out the Council's policy for determining which counter parties to invest with and this list will be restricted by any advice given from the Council's Treasury Advisors or gained from any other source.

6.3. Investment Strategy

6.3.1. The Council's investment strategy for 2010/11 will be based solely on the priorities listed in 6.2.1. above.

6.3.2. The return on the Council's investment will be a tertiary consideration after preservation of capital and the liquidity of our fund. The Council will endeavour to seek the best possible returns through the pro-active management of its cash balances, however, it is anticipated that the opportunities in the current environment will be limited.

6.3.3. The Chief Finance Officer and Head of Resources, under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators.

6.4 Investments managed in-house

6.4.1 The Council's existing investments are a combination of long-dated investments (i.e. with maturities in excess of one year) and short-term investments, and reflect previous treasury management strategies and decisions. The mix of long and short-term investments enables the Council to maintain an appropriate level of liquidity and enables it to mitigate re-investment risk (the risk that a large proportion of maturing investments are reinvested when interest rates are at a cyclical low).

6.4.2. The Council's shorter term cashflow investments are made with reference to the outlook for the UK Bank Rate and money market rates. For these monies, the Council will mainly utilise its business reserve accounts, Money Market Funds and term deposits.

6.4.3. A proportion of the Council's in-house core balances can be invested with a longer-term strategic focus, within the limits the Council has set for Non-Specified Investments:

- Investments in longer-term deposits and in bonds to provide certainty of investment income over the life of the instrument.
- Callable deposits where a higher return is intended to compensate for the uncertainty of the deposit running to maturity.
- The associated increase in credit risk from a longer-term investment is managed by using counterparties meeting the Council's longer-term credit criteria.

6.4.4. The Council's existing longer-term investments are :

- £2m Bank of Ireland – fixed to 24 October 2010 at 6.42%

6.4.5. In addition to this one long term investment, the Council also has a forward rate deal with Clydesdale Bank Plc (part of the National Australia Bank) the details of which are;

£2m fixed from 13 May 2009 to 13 May 2010 at 6.65%

Clydesdale Bank Plc met all the necessary criteria at the time this deal was struck and it has access to the Government's credit guarantee scheme.

6.5 Investments managed externally

6.5.1. The Council currently does not use any external fund managers. Any decision to do so would be subject to approval by the Finance Sub-Committee.

6.6 Collective Investment Schemes (Pooled Funds):

6.6.1. The Council has evaluated the use of Pooled Funds and determined the suitability of their use within the investment portfolio. The reasons for doing so are the continuing importance of investment returns in the Council's overall finances as well as a recognition that investment returns from cash or near cash instruments will be lower in the future.

6.6.2. Pooled funds enable the Council to diversify the assets and the underlying risk in the investment portfolio and provide the potential for enhanced returns. It enables the Council to establish relatively small exposures (£1m - £2m upwards) in appropriate asset classes including those which, if used within segregated funds management mandates, would constitute capital expenditure.

6.6.3. The Council does not currently use this type of investment and any decision to do so in the future will only be undertaken following advice from Arlingclose.

6.7 **Investments which constitute capital expenditure**

6.7.1. Investments meeting the definition of capital expenditure will only be used by this Council following consideration and approval by the Finance Sub-Committee.

7. Balanced Budget Requirement

7.1 The Council complies with the provisions of Section 32 of the Local Government Finance Act 1992 to set a balanced budget.

8 Reporting on the Treasury Outturn

8.1 The Head of Resources will report to the Finance Sub-Committee an outturn report on treasury activity no later than 30 June after the financial year end. A mid year report setting out treasury activity so far that year will be submitted to the Finance Sub-Committee at the first available meeting after the 30 September. Budget monitoring reports will reflect the anticipated return for the year from investments.

APPENDIX A

PRUDENTIAL INDICATORS

1. Background:

1.1. There is a requirement under the Local Government Act 2003 for local authorities to have regard to Cipfa's Prudential Code for Capital Finance in Local Authorities (the "Cipfa Prudential Code") when setting and reviewing their Prudential Indicators. It should be noted that CIPFA undertook a review of the Code in early 2008. The outcome from that review has yet to be published.

2. Estimates of Capital Expenditure:

2.1 This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax and in the case of the HRA, housing rent levels.

No. 1 - Capital Expenditure	2009-10	2009-10	2010-11	2011-12	2012-13
	Approved £m	Revised £m	Estimate £m	Estimate £m	Estimate £m
General Fund	3.195	3.509	8.487	7.842	2.446
Total	**3.195**	**3.509**	**8.487**	**7.842**	**2.446**

3. Ratio of Financing Costs to Net Revenue Stream:

3.1 This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet borrowing costs. The definition of financing costs is set out at paragraph 87 of the Prudential Code.

3.2 The ratio is based on costs net of investment income.

No. 2 - Ratio of Financing Costs to Net Revenue Stream	2009-10	2009-10	2010-11	2011-12	2012-13
	Approved %	Revised %	Estimate %	Estimate %	Estimate %
General Fund	0.00	0.00	0.58	2.61	1.98
Total	**0.00**	**0.00**	**0.58**	**2.61**	**1.98**

Note: this ratio can be negative for Councils in a net investment position and the wording of the above paragraph will need to be amended accordingly.

4. Capital Financing Requirement:

4.1 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and it's financing. It is an aggregation of the amounts shown for Fixed and Intangible assets, the Revaluation Reserve, the Capital Adjustment Account, Government Grants Deferred and any other balances treated as capital expenditure**.

No 3 - Capital Financing Requirement	31/3/09	31/3/09	31/3/10	31/3/11	31/3/12
	Approved	Revised	Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m
General Fund	-2.401	-2.401	-0.390	7.551	3.497
Total CFR	**-2.401**	**-2.401**	**-0.415**	**6.510**	**4.299**

** *in line with CIPFA's guidance, any investments or other items not falling within the classification of fixed or intangible assets, but financed from capital resources must be included within the CFR for the purposes of this calculation.*

Note: The CFR can be a negative amount in situations where resources were required to be set aside under the 1989 Act regime that exceeded the underlying need to borrow.

4.2. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council should make sure that net external borrowing does not, except in the short term, exceed the Capital Financing Requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

4.3. The Council's Chief Finance Officer confirms that this Council had no difficulty meeting this requirement in 2008-09 nor are difficulties envisaged for the current or future financial years.

5 Actual External Debt:

5.1 This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

No. 4 - Actual External Debt as at 31/3/2010	£m
Borrowing	0.000
Other Long-term Liabilities	0.000
Total	**0.000**

6. Incremental Impact of Capital Investment Decisions:

6.1 This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax and Housing Rent levels. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

No. 5 - Incremental Impact of Capital	2009-10	2010-11	2011-12	2012-13

Investment Decisions				
	Approved £m	Estimate £m	Estimate £m	Estimate £m
Increase in Band D Council Tax	5.58	4.93	7.76	3.20

7 Authorised Limit and Operational Boundary for External Debt:

7.1 The Council has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy and practice. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Council and not just those arising from capital spending reflected in the CFR.

7.2 The **Authorised Limit** sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities. This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Council's existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.

7.3 The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.

7.4 The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

No 6 - Authorised Limit for External Debt	2009-10	2009-10	2010-11	2011-12	2012-13
	Approved £m	Revised £m	Estimate £m	Estimate £m	Estimate £m
Borrowing	4.800	4.800	14.800	14.800	14.800
Other Long-term Liabilities	0.200	0.200	0.200	0.200	0.200
Total	**5.000**	**5.000**	**15.000**	**15.000**	**15.000**

7.5. The **Operational Boundary** links directly to the Council's estimates of the CFR and estimates of other cashflow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario.

No. 7 - Operational Boundary for External Debt	2009-10	2009-10	2010-11	2011-12	2012-13
	Approved £m	Revised £m	Estimate £m	Estimate £m	Estimate £m
Borrowing	4.800	4.800	14.800	14.800	14.800

Other Long-term Liabilities	0.200	0.200	0.200	0.200	0.200
Total	**5.000**	**5.000**	**15.000**	**15.000**	**15.000**

8. Adoption of the CIPFA Treasury Management Code:

8.1 This indicator demonstrates that the Council has adopted the principles of best practice.

No. 8 - Adoption of the CIPFA Code of Practice in Treasury Management
The Council approved the adoption of the CIPFA Treasury Management Code at its meeting on 29 April 2002. The Council has incorporated the changes to the revised CIPFA Code of practice into it's treasury policies, procedures and practices.

9. Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure:

9.1 These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. This Council calculates these limits on net principal outstanding sums.

	2009-10	2009-10	2010-11	2011-12	2012-13
	Approved %	Revised %	Estimate %	Estimate %	Estimate %
No . 9 - Upper Limit for Fixed Interest Rate Exposure	100.00	100.00	100.00	100.00	100.00
No. 10 - Upper Limit for Variable Rate Exposure	100.00	100.00	100.00	100.00	100.00

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9.2 The limits above provide the necessary flexibility within which decisions will be made for drawing down new loans on a fixed or variable rate basis; the decisions will ultimately be determined by expectations of anticipated interest rate movements as set out in the Council's treasury management strategy.

10 Maturity Structure of Fixed Rate borrowing:

10.1 This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

10.2 It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

No. 11 Maturity structure of fixed rate borrowing	**Lower Limit %**	**Upper Limit %**
under 12 months	0	100
12 months and within 24 months	0	100
24 months and within 5 years	0	100
5 years and within 10 years	0	100
10 years and above	0	100

11. Upper Limit for total principal sums invested over 364 days:

11.1 The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested. The revised limits for 2009/10 onwards also reflect the overall lower level of investments held by the Council and the need to maintain a sufficient balance for cashflow purposes.

No.12 - Upper Limit for total principal sums invested over 364 days	2009-10	2009-10	2010-11	201-12	2012-13
	Approved £m	Revised £m	Estimate £m	Estimate £m	Estimate £m
	12.000	**12.000**	**6.000**	**6.000**	**6.000**

APPENDIX B

Arlingclose's Forecast for Interest Rates (December 2009)

	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
Official Bank Rate													
Upside risk			+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	**0.50**	**0.50**	**0.50**	**1.00**	**1.50**	**2.00**	**2.50**	**3.00**	**3.00**	**3.00**	**3.00**	**3.00**	**3.00**
Downside risk				-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
1-yr LIBID													
Upside risk			+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	**1.25**	**1.25**	**1.50**	**1.75**	**2.25**	**3.00**	**3.50**	**4.00**	**4.00**	**4.00**	**4.00**	**4.00**	**4.00**
Downside risk				-0.25	-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
5-yr gilt													
Upside risk	+0.25	+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	**2.70**	**2.80**	**2.90**	**3.00**	**3.25**	**3.50**	**3.75**	**4.00**	**4.25**	**4.25**	**4.25**	**4.25**	**4.25**
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
10-yr gilt													
Upside risk		+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.50	+0.50	+0.50	+0.50
Central case	**3.75**	**3.75**	**4.00**	**4.00**	**4.25**	**4.25**	**4.50**	**4.50**	**4.75**	**5.00**	**5.00**	**5.00**	**5.00**
Downside risk		-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
20-yr gilt													
Upside risk	+0.25	+0.50	+0.50	+0.50	+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.50	+0.50	+0.50
Central case	**4.25**	**4.50**	**4.75**	**4.75**	**5.00**	**5.00**	**5.00**	**5.00**	**5.00**	**5.00**	**5.00**	**5.00**	**5.00**
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
50-yr gilt													
Upside risk	+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	**4.25**	**4.50**	**4.50**	**4.50**	**4.75**	**4.75**	**4.75**	**4.75**	**4.75**	**5.00**	**5.00**	**4.75**	**4.75**
Downside risk		-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25

- The recovery in growth is likely to be slow and uneven, more "W" than "V" shaped. The Bank of England will stick to its lower-for-longer stance on policy rates.
- Gilt yields will remain volatile; yields have been compressed by Quantitative Easing and will rise once QE tapers off and if government debt remains at record high levels.
- The path of the base rate has been downgraded to reflect the fragile state of the recovering economy and the severe fiscal correction that will be coming post General Election that will dampen aggregate demand and cut household cashflow. Expectations of central bank exit strategies and their timing will increase volatility in sovereign bond yields and equities.
- There are significant threats to the forecast from potential downgrades to sovereign ratings and/or political instability.

Underlying assumptions:

- The Bank of England's Quantitative Easing (QE) program which injected £200bn to insure against the downside risks to growth and stimulate the economy officially ends 26 January. We estimate that QE has depressed gilt yields by around 70bs (0.7%).
- The Bank forecasts GDP to grow by 4% in 2011 but concedes growth could be impeded by corporate and consumer balance sheet adjustments, restrictions in

bank credit and consumers' cautious spending behaviour. This is an optimistic forecast in our view; evidence of recovery is scant with weak real economic data and rising unemployment. Q4 2009 grew by just 0.1%.

- Looming bank regulation and liquidity and capital requirements will curb bank lending activity. The Bank retains the option to reduce the rate on commercial banks' deposits to encourage them to lend. But FSA regulations will force banks to buy more Gilts which could help slow the rise in yields in 2010/11.
- The employment outlook remains uncertain. Pay freezes, short hours, job cuts and a migration toward part time employment will continue into 2010 keeping the headline unemployment number down.
- Inflation is not an immediate worry for the Bank which forecasts CPI to rise due to higher commodity prices and VAT reverting to 17.5%. Commodity prices and VAT will push inflation over 3% prompting a letter from the Bank's Governor to the Chancellor in Q1 2010.
- The UK fiscal deficit remains acute. Cuts in public spending and tax increases are now inevitable and more likely to be pushed through in 2010 by a new government with a clear majority; however a hung parliament cannot be ruled out and would be potentially disruptive to financial markets.
- The net supply of gilts will rise to unprecedented levels in 2010. Failure to articulate and deliver on an urgent and credible plan to lower government borrowing to sustainable levels over the medium term will be negative for gilts.
- The Federal Reserve Chairman Bernanke's diagnosis of a weak U.S. economy and labour market signal that the Fed's "extended period" of low rates may get even longer. The outlook for the Eurozone is more optimistic but the European Central Bank will only increase rates after a durable upturn in growth.

APPENDIX C

Specified and Non Specified Investments

Specified Investments identified for use by the Council**:**

Specified Investments will be those that meet the criteria in the ODPM Guidance, i.e. the investment

- is sterling denominated
- has a maximum maturity of 1 year
- meets the "high" credit criteria as determined by the Council or is made with the UK government or is made with a local authority in England, Wales and Scotland.
- the making of which is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate).

"Specified" Investments identified for the Council's use are:

- Deposits in the DMO's Debt Management Account Deposit Facility
- Deposits with UK local authorities
- Deposits with banks and building societies
- *Certificates of deposit with banks and building societies
- *Gilts : (bonds issued by the UK government)
- *Bonds issued by multilateral development banks
- Money Market Funds, i.e. 'AAA' liquidity funds with a 60-day Weighted Average Maturity (WAM)
- * Other Money Market Funds and Collective Investment Schemes– i.e. credit rated funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.

1. ** Investments in these instruments will be on advice from the Council's treasury advisor.*

For credit rated counterparties, the minimum criteria will be the short-term ratings assigned by one or more of the following agencies (Moody's Investors Services, Standard & Poor's, Fitch)
Short-term : P-1 (Moody's) or A-1 (S&P) or F1 (Fitch)

Non-Specified Investments determined for use by the Council:

Having considered the rationale and risk associated with Non-Specified Investments, the following have been determined for the Council's use:

	In-House use	Maximum maturity	Max % of portfolio	Capital expenditure?
▪ Deposits with banks and building societies ▪ Certificates of deposit with banks and building societies	✓	*5 yrs*	*50%* in aggregate	No
Gilts and bonds ▪ Gilts ▪ Bonds issued by multilateral development banks ▪ Bonds issued by financial institutions guaranteed by the UK government ▪ Sterling denominated bonds by non-UK sovereign governments	Only after specific report to Finance Sub Committee	*10 years*	*50%* in aggregate	No
Money Market Funds and Collective Investment Schemes (pooled funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573) but which are not credit rated	Only after specific report to Finance Sub Committee)	These funds do not have a defined maturity date	*50%*	No
Bonds and debt instruments (e.g. floating rate notes) issued by corporate bodies	No	*10 years*	*£4m*	**Yes**
Collective Investment Schemes (Pooled funds) which do not meet the definition of collective investment schemes in SI 2004 No 534 or SI 2007 No 573	Only after specific report to Finance Sub Committee)	These funds do not have a defined maturity date	*£4m*	**Yes**

1. In determining the period to maturity of an investment, the investment should be regarded as commencing on the date of the commitment of the investment rather than the date on which funds are paid over to the counterparty.
2. The use of the above instruments by the Council's fund manager(s) will be by reference to the fund guidelines contained in the agreement between the Council and the individual manager.

Appendix D

CRITERIA TO BE USED FOR CREATING/ MANAGING APPROVED COUNTERPARTY LISTS/LIMITS

1. The Chief Financial Officer will formulate suitable criteria for assessing and monitoring the credit risk of investment counterparties and shall construct a lending list comprising time, type, sector and specific counterparty limits.
2. Treasury management staff will add or delete counterparties to/from the approved counterparty list in line with the policy on criteria for selection of counterparties.
3. The Council will use credit criteria in order to select creditworthy counterparties for placing investments with and will take advice as appropriate from the Council's external Treasury Advisors.
4. Credit ratings will be used as supplied from one or more of the following credit rating agencies: -

   Fitch

   Standard & Poor's

   Moody's Investors Services
5. Selection criteria for approved investment counterparties.

   Tier 1 Institutions

   All Local Authorities and Public Bodies
   UK Banks and UK Building Societies which have received a long term credit rating score of AA-/Aa3 or greater and a short term credit rating score of A-1+/F1+/P-1 or greater and have access to the Bank of England Credit Guarantee Scheme.
   Foreign Banks in specific countries which have received a long term credit rating score of AA-/Aa3 or greater and a short term credit rating score of A-1+/F1+/P-1 or greater.

   Tier 2 Institutions

   UK and Designated Foreign Banks and UK Building Societies which have received a long term credit rating score of "A+" or greater and a short term credit rating score of A-1/F1/P-1 or greater.

   Money Market Funds (MMF)

   Funds valued on a Constant Net Asset Value (CNAV) basis with an AAAmmf, Aaa/MR1 or AAAm rating from Fitch, Moody's or Standard and Poor.
6. Investment limits for each tier of counterparty

	Max % of portfolio for each counterparty	Max % of portfolio for tier group
Tier 1	20	100
Tier 2	15	40
MMF	15	40

The limits for each counterparty include any group or subsidiary companies as well. The maximum of portfolio relates to the total of all institutions within any particular tier.

In addition to the above the following criteria should be applied for investments exceeding 1 year.

For Investments up to 5 years:

Tier 1 institutions (as defined above) which also have an Individual rating of B or better and a support/legal rating of 1 or2, a maximum exposure of £5 million in total per institution.

For Investments up to 2 years:

As above, plus other institutions which have an AA- long term rating or better AND F1+ short term rating AND Individual rating of B AND support rating of 2 or better. I would suggest a maximum exposure (if not covered by above) of £4 million. Although this is not a great deal different to above, it does allow some 2nd tier institutions to be considered.

7) The maximum period for investments will be 5 years.
8) The maximum value for any one investment transaction will be £5 million.
9) The maximum level of investment with any one group of counterparties will be 25% of the total portfolio.
10) That a Country limit of 30% for Non-UK Banks of the portfolio be applied.