

Report Title		
Are there background papers?	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
Exempt	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
Reason for Exemption?		
Key Decision?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
If Key Decision is it on the Forward Plan?	<input type="checkbox"/> Yes	<input type="checkbox"/> No
Decision for Full Council?	<input type="checkbox"/> Yes	<input type="checkbox"/> No
Ward(s) affected?	All	
Responsible Cabinet Member name	Peter Moore	
Contact Officer		
E-mail address		
Telephone number		
Are there Non Electronic Appendices?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
List of Background Papers		

File Location:	Accountancy
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PLEASE REFER TO SECTION 7 OF THE GUIDANCE NOTES FOR TEMPLATES		
Implications / Risks:		
Have you identified & explained within the report the implications of the options available to members? (Implications should include financial, legal and links to the Council's existing policies and strategies)	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> None
Have you highlighted the Risks to the Council?	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> None
Financial Implications and Risks to the Council should have their own separate headings. It is not acceptable to simply state that financial implications or risks have been alluded to in the main body of the report.		

This report has been subject to the following processes:

Consultations with:		
Cabinet Member	<input type="checkbox"/> Yes	If not please state reason below
Local Member	<input type="checkbox"/> Yes	If not please state reason below
S151 Officer	<input checked="" type="checkbox"/> Yes	If not please state reason below
Monitoring Officer	<input type="checkbox"/> Yes	If not please state reason below
Democratic Services Manager	<input type="checkbox"/> Yes	If not please state reason below
Communications Manager	<input type="checkbox"/> Yes	If not please state reason below
Other Head(s) of Service:		
Others:		

Please confirm this report has been signed off by:		
Management Team	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> Not apt
Relevant Strategic Director	<input type="checkbox"/> Yes	<input type="checkbox"/> Not apt
The Chief Executive	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> Not apt

Agenda Item No

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

Summary:	This report set out details of the Council's treasury management activities and presents a strategy for the prudent investment of the Council's surplus funds for members to approve.
Conclusions:	The preparation of this Strategy Statement is necessary to comply with the Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services.
Recommendations:	That the Council be asked to RESOLVE that the Treasury Management Strategy Statement and Investment Strategy, for 2010/11 to 2012/13, be approved.

Cabinet member(s):	Ward(s) affected:
All	All
Contact Officer, telephone number, and e-mail:	

1. Introduction

- 1.1 The Council considers, at the start of each new financial year, an annual Treasury Management Strategy Statement (TMSS) under the requirements of the CIPFA Code of Practice on Treasury Management. This statement also incorporates the Annual Investment Strategy which sets out the Council's policies for managing investments and for giving priority to the security and liquidity of those investments.
- 1.2 In response to the financial crisis in 2008 and the collapse of the Icelandic banks, CIPFA revised the Treasury Management Code and Guidance Notes as well as the Prudential Indicators in late November 2009. Communities and Local Government (CLG) is also in the process of revising and updating the Investment Guidance. Any changes required to be made to this Strategy as a result of this new guidance will be presented to members for consideration in due course.
- 1.3 The Council is required to have regard to the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. The indicators to which regard should be given when determining the Council's treasury management strategy are included in the Prudential Indicators report included elsewhere on this agenda.

2. Background

- 2.1 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.”

2.2 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 and include:

- Liquidity Risk (Adequate cash resources)
- Market or Interest Rate Risk (Fluctuations 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 (Compliance with statutory and regulatory requirements).

2.3 This strategy takes into account the impact of the Council's Revenue Budget and Capital Programme on the Balance Sheet position. The projected treasury position for 2009/10 to 2012/13 is as follows:

	Forecast Outturn £000s 2009-10	Estimate £000s 2010-11	Estimate £000s 2011-12	Estimate £000s 2012-13
Total external debt	Nil	Nil	Nil	Nil
Total Investments (Managed in-house)	£22,753,000	£22,541,000	£16,059,000	£14,842,000
Average Interest Rate	3.16%	2.44%	3.07%	3.80%
Interest Receivable	£719,000	£550,000	£493,000	£564,000

2.4 The underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) together with Balances and Reserves are the core drivers of Treasury Management Activity. The estimates, based on the current Revenue Budget and Capital Programmes, are set out below:

	31 Mar 10 Estimate £000s	31 Mar 11 Estimate £000s	31 Mar 12 Estimate £000s	31 Mar 13 Estimate £000s
CFR	Nil	Nil	Nil	Nil
Balances & Reserves	£14,207,000	£10,098,000	£7,977,000	£7,633,000
Net Balance Sheet Position	£14,207,000	£10,098,000	£7,977,000	£7,633,000

2.5 The Council's level of physical debt and investments is linked to these components of the Balance Sheet. The Council's CFR is anticipated to be zero over the life of the Strategy and no external borrowing for capital purposes is therefore anticipated. Market conditions, interest rate expectations and credit risk considerations will influence the Council's strategy in determining the borrowing and investment activity against the underlying Balance Sheet position.

- 2.6 The move to International Financial Reporting Standards (IFRS) has implications for the Capital Financing Requirement components on the Balance Sheet. Analysis of the Council's Operating leases against IFRS requirements may result in the related long term assets and liabilities being brought onto the Council's Balance Sheet. The estimates for the CFR and Long Term Liabilities will therefore need to take into account such items and will influence the determination of the Council's Affordable Borrowing Limit and Operational Boundary.

3. Outlook for Interest Rates

- 3.1 The economic interest rate outlook provided by the Council's treasury advisor, Arlingclose Ltd, is attached at Appendix ?. Financial markets remain reasonably volatile as economies and the banking system respond to the financial crises. The Council will keep its Treasury Strategy under review and realign it with evolving market conditions and expectations for future interest rates if required.

4. Investment Policy and Strategy

- 4.1 Guidance from CLG requires that local authorities set an Annual Investment Strategy (AIS). The Guidance permits the TMSS and the AIS to be combined into one document.
- 4.2 To comply with the CLG's guidance, the Council's general policy objective is to invest its surplus funds prudently. The Council's investment priorities are:
- Security of the invested principal;
 - Liquidity of the invested principal;
 - An optimum yield which is commensurate with security and liquidity.

The speculative procedure of borrowing purely in order to invest is unlawful.

- 4.3 Investments are categorised as 'Specified' or 'Non Specified' investments based on the criteria in the government guidance. Potential instruments for the Council's use within its investment strategy are contained in Appendix ?.
- 4.4 The credit crisis has refocused attention on the treasury management priority of security of capital monies invested. The Council will continue to maintain a counterparty list based on its approved criteria, and will monitor and update the credit standing of the institutions on a regular basis. This assessment will include credit ratings and other alternative assessments of credit strength as outlined in paragraph 4.13.
- 4.5 The Council's estimated levels of investments are set out in 2.3 of this TMSS.
- 4.6 The global financial market turmoil in 2008 and 2009 has forced investors of public money to reappraise the question of risk versus yield. Income from investments is a key support in the Council's budget.
- 4.7 The UK Bank Rate has been maintained at 0.5% since March 2009. Short-term money market rates are likely to remain at very low levels which will have a significant impact on investment income. The Council's investment strategy will as far as possible mitigate this development whilst adhering to the principal objective of security of invested monies.
- 4.8 The Financial Services Manager, 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. Decisions taken on the core investment portfolio will be reported to Cabinet.

- 4.9 The Council's shorter term cash flow investments are made with reference to the outlook for the bank base and money market rates.
- 4.10 In any period of significant stress and uncertainty in the markets, the Council will revert to its default position of safety, and place all investments with the Debt Management Office.
- 4.11 Currently the Council has restricted its investment activity to:
- The Debt Management Agency Deposit Facility (The rates of interest from the DMADF are below equivalent money market rates. However, the returns are an acceptable trade-off for the guarantee that the Council's capital is secure)
 - AAA-rated Money Market Funds with a Constant Net Asset Value (CNAV)
 - Deposits with other local authorities
 - Business reserve accounts and term deposits. These have been restricted to UK institutions that are rated at least AA- long term, and have access to the UK Government's 2008 Credit Guarantee Scheme (CGS)
 - Bonds issued by Multilateral Development Banks
- 4.12 Conditions in the financial sector have begun to show signs of improvement, albeit with substantial government intervention. In order to diversify the counterparty list, the use of comparable non-UK Banks for investments is now considered appropriate.
- 4.13 The sovereign states whose banks are now considered to be appropriate to be included are Australia, Canada, Finland, France, Germany, Netherlands, Spain, Switzerland and the US. These countries, and the Banks within them have been selected after analysis and careful monitoring of:
- Credit Ratings (minimum long-term AA-)
 - Credit Default Swaps
 - GDP; Net Debt as a Percentage of GDP
 - Sovereign Support Mechanisms/potential support from a well-resourced parent institution
 - Share Price
- 4.14 The Council has also taken into account information on corporate developments and market sentiment towards the counterparties. The Council and its Treasury Advisors, Arlingclose, will continue to analyse and monitor these indicators and credit developments on a regular basis and respond as necessary to ensure security of the capital sums invested.
- 4.15 The Council remains in a heightened state of awareness and sensitivity to risk, and continues to remain vigilant. This modest expansion of the counterparty list is considered appropriate and provides access to additional counterparties if required. In order to meet the requirements of the CIPFA Treasury management Code, the Council is focusing on a range of indicators, not just credit ratings.
- 4.16 To protect against a prolonged period of low interest rates, 1-year deposits and longer-term secure investments will be actively considered within the limits the Council has set for Non-Specified Investments. The longer-term investments will be likely to include:
- Supranational bonds (bonds issued by multilateral development banks). European government guarantees in place on these bonds provide security of the principal invested. Even at the lower interest rates likely to be in force, the return on these bonds could be attractive relative to the increasingly low outlook for official interest rates.
 - UK government guaranteed bonds and debt instruments issued by banks and building societies. The UK Government's 2008 Credit Guarantee Scheme permits

specified UK institutions to issue short-dated bonds with an explicit government guarantee and would be a secure longer-term investment option. These bonds would, under existing statute be capital expenditure investments. It may also include sterling denominated bonds issued by financial institutions where the bond enjoys a non UK government sovereign guarantee.

- 4.17 The Council has evaluated the use of Pooled Funds to determine the appropriateness of use within the investment portfolio. Pooled funds enable the Council to diversify the assets and the underlying risk in the investment portfolio and provide the potential for enhanced returns.
- 4.18 Investments in pooled funds will be undertaken with advice from Arlingclose and their performance and suitability in meeting the Council's investment objectives are regularly monitored.
- 4.19 Investments meeting the definition of capital expenditure can be financed from capital or revenue resources. They are also subject to the CLG's Guidance on "non-specified investments" and placing such investments has accounting, financing and budgetary implications. Under the CLG's MRP Guidance, MRP must be applied over a 20 year period. The Council has determined a maximum limit of £7.5m for investments which constitute capital expenditure.

5. 2010/11 Minimum Revenue Provision (MRP) Statement

- 5.1 The Local Authorities (Capital Finance and Accounting)(England)(Amendment) Regulations 2008 (SI2008/414) place a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Secretary of State and local authorities are required to "have regard" to such guidance under section 21 (1A) of the Local Government Act 2003.
- 5.2 There are four alternative methods available to the Council. The Council's CFR at 31 March 2010 is estimated to be £Nil and as such, under the CFR calculation method, there will be no requirement to make a MRP. However, if leases are brought onto the balance sheet as a result of accounting or IFRS requirements, the CFR will increase leading to a MRP charge to revenue. This MRP charge will match the annual principal repayment for the associated liability under the lease.

6. Reporting on the Treasury Outturn

- 6.1 The Technical Accountant will report to Cabinet and Scrutiny Committee on treasury management activity and performance as follows:
- The treasury management position is monitored during the year as part of the budget monitoring process. In addition, quarterly reports are presented to Cabinet and Scrutiny Committee.
 - The Council will produce an outturn report on its treasury activity no later than 30 September after the financial year end.
 - The Overview and Scrutiny Committee will be responsible for the scrutiny of treasury management activity and practices.

7. Member Training

- 7.1 CIPFA's revised Code requires the "responsible officer" to ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understands fully their roles and responsibilities.

8. Risks to the Council

- 8.1 The strategy ensures that the identification, monitoring and control of risk (as detailed at 2.2) are the prime criteria by which treasury activities are undertaken.

9. Financial Implications

- 9.1 The effectiveness of the treasury strategy will have a significant impact on the budget and finances of the Council. Investment decisions will be made based on the Council's forecast of interest rate movements. If actual rate movements prove to be very different, there will be implications for the investment return achieved.
- 9.2 It is not possible to predict with certainty the future movements in interest rates. The Strategy must therefore be flexible enough to allow the Council to respond to changing market conditions. It must also enable the Council to respond to future changes in legislation.
- 9.3 The security of the Council's investments is of prime concern, and the Strategy must ensure that, as far as possible, the Council's investments are repaid in full, with interest earned, on the due date.

Arlingclose's Forecast for Interest Rates - December 2009

	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12
Official Bank Rate										
Upside risk				+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	0.50	0.50	0.50	0.50	1.00	1.50	2.25	3.00	4.00	4.00
Downside risk					-0.50	-0.50	-0.50	-0.25	-0.25	-0.25
1-yr LIBID										
Upside risk				+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	1.25	1.25	1.25	1.50	2.00	2.75	3.50	4.00	4.25	4.25
Downside risk					-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
5-yr gilt										
Upside risk		+0.25	+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	2.60	2.70	2.80	2.90	3.00	3.25	3.50	3.75	4.00	4.25
Downside risk		-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
Central case	3.60	3.75	3.75	4.00	4.00	4.25	4.25	4.50	4.50	4.75
Downside risk			-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
20-yr gilt										
Upside risk		+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.25
Central case	4.10	4.25	4.50	4.75	4.75	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
50-yr gilt										
Upside risk	+0.25	+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	4.00	4.25	4.50	4.50	4.50	4.75	4.75	4.75	4.75	4.75
Downside risk			-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.
- Central banks will eventually wind down and exit their emergency liquidity provisions and shrink their balance sheets, but official interest rates in the UK, Eurozone and US will stay low for some while.
- There are significant threats to the forecast from potential downgrades to sovereign ratings and/or political instability.

Underlying assumptions

- The Bank of England has increased Quantitative Easing (QE) to £200bn to insure against the downside risks to growth and stimulate the economy.
- 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.
- Looming bank regulation and liquidity and capital requirements will curb banking lending activity. The Bank retains the option to reduce the rate on commercial banks' deposits to encourage them to lend.
- The employment outlook remains uncertain. Pay freezes and job cuts will continue into 2010.
- Inflation is not an immediate worry. The Bank's forecast is for CPI to rise in the next few months from higher commodity prices and VAT reverting to 17.5%, but is forecast to remain below 2% in the short term, only surpassing the target in 2012. There is a risk that inflation overshoots in 2010 prompting a letter from the Bank's Governor to the Chancellor.
- 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.
- 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 the Eurozone is more optimistic but the European Central Bank will only increase rates after a durable upturn in growth.

Specified and Non Specified Investments

Specified Investments identified for use by the Council:

Specified Investments will be those that meet the criteria in the CLG 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
 - AAA-rated Money Market Funds with a Constant Net Asset Value (Constant NAV)
 - 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.
2. The use of the above instruments by the Council’s fund manager(s), if one were to be appointed, will be by reference to the fund guidelines contained in the agreement between the Council and the individual manager.

For credit rated counterparties, the minimum criteria will be the long-term ratings assigned by various agencies which may include Moody’s Investors Services, Standard & Poor’s, or Fitch.

Long-term minimum: AA- (Fitch and S&P) or Aa3 (Moody’s)

The Council will also take into account information on corporate developments and market sentiment towards investment counterparties.

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	Use by fund managers	Maximum maturity	Max % of portfolio	Capital expenditure?
Deposits with banks and building societies Certificates of deposit with banks and building societies	✓ ✓	 ✓	5 yrs	60% 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	 ✓ (on advice from treasury advisor)	 ✓	10 years	75% 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	 ✓ (on advice from treasury advisor)	 ✓	These funds do not have a defined maturity date	50%	No

Government guaranteed bonds and debt instruments (e.g. floating rate notes) issued by corporate bodies	✓	✓	10 years	£7.5m	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	✓ (on advice from treasury advisor)	✓	These funds do not have a defined maturity date	£5m	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) if one were to be appointed will be by reference to the fund guidelines contained in the agreement between the Council and the individual manager.