BROMSGROVE DISTRICT COUNCIL

CABINET

4TH MARCH 2009

TREASURY MANAGEMENT STRATEGY STATEMENT AND INVESTMENT STRATEGY 2009-10 TO 2011-12

Responsible Portfolio Holder	Cllr Geoff Denaro
Responsible Head of Service	Head of Financial Services – Jayne Pickering

1. SUMMARY

1.1 A strategy statement for the treasury management and investments in relation to Bromsgrove District Council to comply with the Local Government Act 2003 and to ensure the Council demonstrates accountability and effectiveness in the management of its funds.

2. RECOMMENDATION

2.1 The strategy and prudential indicators shown at Appendix A and B, be approved and adopted.

2.2 That Cabinet request Full Council to approve the Authorised Limit for borrowing at £6,000,000 as required by CIPFA (this is the same as the Affordable Borrowing Limit as required by Section 3(1) of the Local Government Act 2003.)

2.3 That Cabinet request Full Council to approve the maximum level of investment to be held within each organisation (i.e. bank or building society) as detailed at £3m subject to market conditions.

2.4 That Cabinet request Full Council to approve an unlimited level for investment in Debt Management Account Deposit Facility (DMADF).

3. BACKGROUND

3.1 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 Treasury Management Strategy Statement (TMSS) for borrowing each financial year.

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

3.3 CIPFA has defined Treasury Management as:

"the management of the organisation's 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."

3.4 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 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).

4. <u>FINANCIAL IMPLICATIONS</u>

4.1 The financial implications are contained within the body of the strategy statement at Appendix A.

5. <u>LEGAL IMPLICATIONS</u>

5.1 This is a statutory report under the Local Government Act 2003.

6. <u>CORPORATE OBJECTIVES</u>

6.1 Approval of this strategy statement will ensure that the Council invests its resources within a robust and effective framework to deliver a maximum return on investments within a secure environment.

7. <u>RISK MANAGEMENT</u>

7.1 The main risks associated with the details included in this report are:

- *Poor Use of Resources scoring*
- *Poor investment return*
- *Loss of capital due to investing with inappropriate organisations*

7.2 These risks are being managed as follows:

- Poor Use of Resources scoring

  Risk Register: *Corporate*
  Key Objective Ref No: *1*
  Key Objective: *Effective Financial Management*

7.3 The risks associated with the delivery of maximum return within a secure environment have now been addressed in the risk register. The risks and controls in place to mitigate them have been assessed and detailed within the register.

7.4 Current controls to reduce the risk of loss of capital and poor return on investment include:

- Monthly reports from investment managers on performance of funds
- Quarterly reporting to Performance Management Board and Cabinet of financial position on investments
- Monthly updates from treasury advisors in respect of level of status for organisations we invest with
- Daily monitoring by internal officers of banking arrangements and cash flow implications

8. CUSTOMER IMPLICATIONS

8.1 The effective management of treasury operations will ensure that the management of the public funds is monitored and reviewed in a complaint way to satisfy the public of the use of their financial resources.

9. EQUALITIES AND DIVERSITY IMPLICATIONS

9.1 None as a direct result of this strategy

10. VALUE FOR MONEY IMPLICATIONS

10.1 The robust framework that is in place to ensure investments maximise return within a secure environment support the demonstration that the Council is providing value for money is the use of its funds available.

11. OTHER IMPLICATIONS

Procurement Issues -None
Personnel Implications None
Governance/Performance Management None
Community Safety including Section 17 of Crime and Disorder Act 1998 None
Policy None
Environmental None

12. OTHERS CONSULTED ON THE REPORT

Portfolio Holder	**No**
Chief Executive	**No**
Executive Director (Partnerships and Projects)	**No**
Executive Director (Services)	**No**
Assistant Chief Executive	**No**
Head of Financial Services	**Yes**
Head of Legal, Equalities & Democratic Services	**No**
Head of Organisational Development & HR	**No**
Corporate Procurement Team	**No**

13. WARDS AFFECTED

All wards

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Treasury Management Strategy Statement
and Investment Strategy 2009-10 to 2011-12

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<u>**Appendices**</u>

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 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 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 strategy also takes into account the outlook for interest rates, the Council's current treasury position and its approved Prudential Indicators (attached as Appendix A). The PIs relevant to the treasury management strategy are set out below:

PI No.		2008-09 Approved	2008-09 Revised	2009-10 Estimate	2010-11 Estimate	2011-12 Estimate
6	Authorised Limit for External Debt	*£6m*	*£6m*	*£6m*	*£6.5m*	*£7.5m*
7	Operational Boundary for External Debt	*£5m*	*£5m*	*£5m*	*£5.5m*	*£6.5m*
9	Upper Limit for Fixed Interest Rate Exposure	*100 %*	*100 %*	*100 %*	*100 %*	*100 %*
10	Upper Limit for Variable Rate Exposure	*100 %*	*100 %*	*100 %*	*100 %*	*100 %*
12	Upper Limit for total principal sums invested over 364 days	*£16.0m*	*£16.0m*	*£3.0m*	*£3.0m*	*£3.0m*

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%

1.5 This TMSS also incorporates the Council's Investment Strategy.

2. The Treasury Position

2.1 The estimated treasury position for 31/3/2009 and for the following financial years is:

	31/3/2009 Estimate £m	31/3/2010 Estimate £m	31/3/2011 Estimate £m	31/3/2012 Estimate £m
Total external debt	0	0	0.229	1.100
Total Investments	10.312	7.396	5.708	4.608

2.2 The estimate for interest receipts in 2009-10 is £0.150m.

3. Outlook for Interest Rates

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

(a) Background
Central bankers acted decisively in October 2008 as the effective breakdown of financial systems threatened to destabilise the global economy. It included government sponsored recapitalisations, interventions through the provision of liquidity and guarantees for lending; in some instances nationalisation of private sector financial institutions; the removal of compromised assets from banks' balance sheets through special finance mechanisms; and co-ordinated emergency interest rates cuts. The UK, Eurozone and US economies contracted in the third and fourth quarters of 2008.

(b) Outlook

- **Availability of credit** is likely expected to remain restricted and credit conditions challenging, particularly as banks change their lending behaviour and lower their lending risk. The poorly functioning transmission mechanism for lower rates to be passed to consumers could cause governments to intervene directly between banks and corporates/individuals.
- **Inflation** : The elevated levels of commodity, food and energy inflation which exerted a powerful squeeze on real incomes in 2008 are expected to fade in 2009. CPI, which had risen to 5.2% in 2008, is now expected to fall below the MPC's lower boundary of 1%. Whilst this will provide consumers some relief, lower inflation erodes debt burdens more slowly.
- **Labour market** : Unemployment, already at 6%, is expected to rise further. The fear of unemployment will keep wage bargaining and wage inflation to a minimum.
- **Housing / Consumer Confidence** : The prospect of negative housing equity, and/or rising unemployment and depressed asset values could culminate in a further negative loop-back for confidence. Consumers and businesses will scale back spending to conserve or repair their balance sheets.
- **Growth :** The effort to reduce erstwhile ballooning debt will hit economic activity and growth in the UK, US and in Europe. The prospects for growth remains uniformly poor in for much of 2009. Asset values are forecast to drop further, particularly those which are commodities- and housing-related.
- **Interest rates / Central Bank policies** : To avoid deflation and to mitigate the severity of the economic slowdown, there will be a growing willingness by Central Bankers to countenance abnormally low interest rates and/or some form of quantitative easing (i.e. using more unconventional methods such as expanding the central bank's balance sheet and injecting cash into the economy), sooner rather than later.
  - **UK** : During the autumn on 2008, the Bank of England's Monetary Policy Committee cut rates by a cumulative 3%, bringing the Bank Rate down to 2%, a level the Bank

deemed appropriate for the prevalent economic conditions. The Bank Rate will be cut to 1% or lower.

- **US** : The Federal Funds rate was cut to 1%, before the decision in December 2008 to lower the rate to a range between 0% and 0.25% alongside the announcement of quantitative easing policies (among them, the purchase of large and unlimited quantities of agency and mortgage backed debt and the potential purchase of longer term Treasuries).
- **Euroland** : The European Central Bank is expected to cut rates more cautiously from the current level of 2.5% due to the different imbalances in each of the member states.

Market conditions and volatility : Market volatility remains high, risk appetite at a low ebb; markets are expected to continue in 'capital preservation mode' into early 2009. Although Libor is falling, the gap between official and market interest rates is likely to remain relatively wide for some months to come.

The deterioration in public finances – both via the cost of shoring up the financial system and also as recession hits the government's revenue streams – and the burgeoning budget deficit will require significant new gilt issuance in 2009. This excess supply is expected to push longer dated yields higher although not aggressively so. Short-dated gilt yields are however expected to fall with the gathering momentum of a fall in official policy rates.

The price destruction in equities will keep stock markets subdued and, even though there may be tentative signs of stability, it would be too early to say if a bottom has been reached.

Arlingclose's forecast for the UK Bank Rate (December 2008) is :

	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
Official Bank Rate									
Upside risk							+0.25	+0.25	+0.25
Central case	**1.00**	**1.00**	**1.00**	**1.00**	**1.00**	**1.50**	**2.00**	**2.50**	**2.50**
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.50	-0.50	-0.50	-0.50

The probability or zero or near zero interest rates – unthinkable just a few months ago – is now very high. The economic outlook provides both opportunities and challenges for the Council's treasury strategy in FY 2009-10.

4. <u>Borrowing Requirement and Strategy</u>

4.1 The Council's underlying need to borrow for capital purposes is measured by reference to its Capital Financing Requirement (CFR) – see Appendix <u>A.</u> The CFR will determine the Council's requirement to make a Minimum Revenue Provision for Debt Redemption (MRP) from within its Revenue budget. Physical borrowing may be greater or less than the CFR.

PI No. 4 **Capital Financing Requirement**	31/3/2009 Approved £m	31/3/2009 Revised £m	31/3/2010 Estimate £m	31/3/2011 Estimate £m	31/3/2012 Estimate £m
General Fund CFR	0.024	0	0	0.229	1.296
Total CFR	**0.024**	**0**	**0**	**0.229**	**1.296**

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4.2 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.

4.3 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 (the underlying need to borrow) and may in turn produce an increased requirement to charge MRP in the Revenue Account.

4.4 The cumulative estimate of the long-term borrowing requirement calculated as follows:

	31/3/2009 Revised Estimate £m	31/3/2010 Estimate £m	31/3/2011 Estimate £m	31/3/2012 Estimate £m
Capital Financing Requirement	0	0	0.229	1.296
Less: Existing Profile of Borrowing and Other Long Term Liabilities	0	0	0	0.196
Borrowing Requirement	**0**	**0**	**0.229**	**1.100**

4.5 Over the past 6 years the Council has not entered into any long-term borrowing arrangements due to the significant capital receipts generated. However, the Medium Term Financial Plan for 2009-10 to 2011-12 estimates that utilisation of capital receipts will decrease by 2010-11 to a level which will result in the Council looking to borrow to fund future capital programmes. The Council will 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 financial year to assess whether it may be appropriate to borrow in advance of need in 2010-11 and 2011-12. The Council will take a prudent and pragmatic approach to borrowing to minimise borrowing costs without compromising the longer-term stability of the portfolio, consistent with the Council's Prudential Indicators. Advice will be sought from the Council's treasury advisor, Arlingclose, including the timing of borrowing.

4.6 In conjunction with advice from its treasury advisor, Arlingclose Ltd, 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).

4.7 Short-dated gilt yields are forecast to be considerably lower than medium- and long-dated gilt yields during the financial year. Despite additional gilt issuance to fund the UK government's support to the banking industry, short-dated gilts are expected to benefit from expectations of lower interest rates as the economy struggles through a recession. Yields for these maturities will fall as expectations for lower interest rates mount.

The outlook for borrowing rates:

4.8 *Variable Rate borrowing* : The shocks in the financial markets in the second half of 2008 leaves the UK in a different era in respect of official interest rates which are forecast to fall below 2%. By December 2008 the rates for PWLB variable-rate borrowing had fallen substantially and are forecast to fall to altogether very low levels as the Bank Rate is cut further.

4.9 *Fixed rate borrowing* : Gilts across all maturities will initially benefit from their status of safe haven assets in uncertain economic times. As yields fall initially, fixed PWLB rates across most maturities could challenge historic lows. As the UK Bank Rate falls to 1% or lower, short-dated yields and PWLB rates should provide some attractive fixed rate borrowing opportunities.

4.10 The Council will evaluate with Arlingclose the relative merits of a strategic exposure to variable rate debt. Decisions to borrow at low, variable rates of interest will be taken after considering the absolute level of longer term interest rate equivalents and the extent of variable rate earnings on the Council's investment balances. Should longer term rates move below the cost of variable rate borrowing any strategic exposure to variable interest rates will be reviewed and, if appropriate, reduced.

4.11 The Council will undertake a financial options appraisal process to establish how it has arrived at its 'value for money' judgement in the use of resources.

5. Investment Policy and Strategy

Background

5.1 Guidance from the then ODPM (now DCLG) on Local Government Investments in England requires, similarly, that an Annual Investment Strategy (AIS) be set. The Guidance permits the TMSS and the AIS to be combined into one document.

Investment Policy

5.2 The Council's general policy objective is to invest its surplus funds prudently. The Council's investment priorities are:

- security of the invested capital;
- liquidity of the invested capital;
- an optimum yield which is commensurate with security and liquidity.

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

5.3 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.

5.4 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 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 (for example, statements of potential government support). The Council will also take into account information on corporate developments of and market sentiment towards investment counterparties.

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5.5 The Council's estimated levels of investments are set out in 2.1 of this TMSS.

Investment Strategy

5.6 The global financial market storm in 2008 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.

5.7 By January 2009 the UK Bank Rate had fallen to 1.5%, its lowest level since 1694. **It is expected that the Bank Rate will fall to near zero in FY 2009-10, short-term money market rates will continue to fall to very low levels which will have a significant impact on investment income**. The Council's strategy must however be geared towards this development whilst adhering to the principal objective of security of invested monies.

5.8 The Head of Financial Services, 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 the Cabinet meeting.

During the current economic climate investments in excess of the usual limit for one institution may be exceed at the discretion of the Head of Finance.

Investments managed in-house :

5.9 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 invest in

- 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 (Constant NAV) investing predominantly in government securities
- AAA-rated Money Market Funds with a Constant Net Asset Value (Constant NAV) investing in instruments issued primarily by financial institutions;
- Deposits with other local authorities
- Business reserve accounts
- Term deposits
- Certificates of deposit.

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5.10 Protection against the downward move in interest rates through 1-year deposits and through longer-term secure investments will be actively considered within the limits the Council has set for Non-Specified Investments and will likely include :

- **Supranational bonds (bonds issued by multilateral development banks):** The joint and individual pan European government guarantees in place on these bonds provide security of the principal invested. Even at the lower yields 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/building societies** : The UK Government's 2008 Credit Guarantee Scheme permits specific UK institutions to issue of short-dated bonds with an explicit government guarantee. The bonds are issued at a margin over the underlying gilt and would be a secure longer-term investment option. (These bonds would, under existing statute, be capital expenditure investments.)

Investments managed externally

Funds managed on a segregated basis

5.11 The Council's funds are also managed on a discretionary basis by HSBC. The fund's remit allows the managers scope to add value through the use of investments contained in Appendix C and within the parameters and guidelines set for the Council's fund. Revised parameters were agreed with HSBC in 2008-09 to lower market risk and volatility in the portfolio. Performance is monitored and measured against the benchmark set for the fund, prevailing economic conditions and investment opportunities.

5.12 HSBC will report monthly. The manager's performance will be monitored quarterly and measured against the benchmark set for the fund, prevailing economic conditions and investment opportunities.

Collective Investment Schemes (Pooled Funds):

5.13 The Council has evaluated the use of Pooled Funds and determined the appropriateness of their 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.

5.14 Investments in pooled funds will be undertaken with advice from Arlingclose. The Council's current investments in Pooled Funds are listed in section 2.1; their performance and continued suitability in meeting the Council's investment objectives are regularly monitored.

6. Balanced Budget Requirement

6.1 The Council complies with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget.

7. Annual MRP Statement

7.1 The Local Authorities (Capital Finance and Accounting)(England)(Amendment) Regulations 2008 (SI 2008/414) 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.

7.2 The four MRP options available are:
Option 1: Regulatory Method
Option 2: CFR Method
Option 3: Asset Life Method
Option 4: Depreciation Method

7.3 The Council's CFR at 31st March 2008 is estimated to be £Nil/Negative and as such under Option 2 (the CFR Method) there is no requirement to charge MRP.

8. Reporting on the Treasury Outturn

8.1 The Head of Financial Services will report on treasury management activity/performance as follows:
(a) Investment income and return will be monitored and reported on quarterly. The report to members on investment income will be received as part of the quarterly financial and performance monitoring reports to the Performance Monitoring Board and Cabinet.

(b) The Council will produce an outturn report on its treasury activity no later than 30th September after the financial year end.

9. Other items

CIPFA review of the Prudential Code.

9.1 In early 2008 CIPFA undertook a consultation exercise to review the implementation and ongoing use of the Prudential Code. CIPFA has yet to publish its conclusions arising from the consultation process. In the event that amendments are made to the Code by CIPFA, these may need to be reflected in the Treasury Management and Investment Strategy documentation.

PRUDENTIAL INDICATORS

Background:
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.

Prudential Indicators FY 2009-10 to FY 2011-12

1 Background:
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**	2008-09	2009-10	2010-11	2011-12
		£m	Estimate £m	Estimate £m	Estimate £m
	General Fund	9.516	3.389	2.161	1.510
	Total	**9.516**	**3.389**	**2.161**	**1.510**

2.2 Capital expenditure will be financed as follows:

Capital Financing	2008-09	2009-10	2010-11	2011-12
	Approved £m	Estimate £m	Estimate £m	Estimate £m
Capital receipts	8.544	2.515	1.622	0.100
Government Grants	0.489	0.514	0.310	0.310
Capital Contributions	0.483	0.360		
Revenue Contributions				
Supported borrowing			0.229	1.100
Unsupported borrowing				
Total	**9.516**	**3.389**	**2.161**	**1.510**

The estimates are as per the Capital Programme 2009-10 to 2011-12 to take account of the use of capital receipts per the Cabinet Report of 3rd December 2008. The element to be financed from borrowing in 2010/11 impacts on the movement in the Capital Financing Requirement.

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	2008-09	2008-09	2009-10	2010-11	2011-12
		Approved	Revised	Estimate	Estimate	Estimate
	General Fund	-3.74%	-7.80%	-1.27%	-0.94%	-0.58%

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 its 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	31/3/08	31/3/08	31/3/09	31/3/10	31/3/11
		Approved	Revised	Estimate	Estimate	Estimate
		£m	£m	£m	£m	£m
	General Fund	0.024	--	--	0.299	1.296
	Total CFR	**0.024**	**--**	**--**	**0.299**	**1.296**

4.2 The year–on-year change in the CFR is due to the following

Capital Financing Requirement	2008-09	2008-09	2009-10	2010-11	2011-12
	Approved £m	Revised £m	Estimate £m	Estimate £m	Estimate £m
Balance B/F	0.024	0	--	--	0.229
Capital expenditure financed from borrowing (per 2.2)	--	--	--	0.229	1.100
Revenue provision for debt Redemption.	--	--	--	--	0.033
Other items *(specify)*	--	--	--		
Balance C/F	**0.024**	**0**	**--**	**0.229**	**1.296**

4.3 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.

4.4 The Head of Financial Services reports 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 31/3/2008	£'000s
	Borrowing	109
	Other Long-term Liabilities	--
	Total	**109**

The short term borrowing as at 31st March 2008 was for the management of the Council's cash flow requirements.

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 Investment Decisions	2008-09	2009-10	2010-11	2011-12
		Approved £	Estimate £	Estimate £	Estimate £
	Increase in Band D Council Tax	**£8.99**	**£0.31**	**£0.50**	**£1.15**

6.2 The impact on Band D council tax reflects the reduction in investment income due to depletion of capital receipts to finance the capital programme.

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	2008-09	2008-09	2009-10	2010-11	2011-12
		Approved £m	Revised £m	Estimate £m	Estimate £m	Estimate £m
	Borrowing	6.0	6.0	6.0	6.5	7.5
	Other Long-term Liabilities	--	--	--	--	--
	Total	**6.0**	**6.0**	**6.0**	**6.5**	**7.5**

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 but without the additional headroom included within the Authorised Limit.

7.6 The Head of Financial Services has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the next meeting of the Cabinet

No. 7	**Operational Boundary for External Debt**	2008-09	2008-09	2009-10	2010-11	2011-12
		Approved £m	Revised £m	Estimate £m	Estimate £m	Estimate £m
	Borrowing	5.0	5.0	5.0	5.5	6.5
	Other Long-term Liabilities	--	--	--	--	--
	Total	**5.0**	**5.0**	**5.0**	**5.5**	**6.5**

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 18th May 2005.

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.

9.2 The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises which could adversely impact on the revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments

		2008-09	2008-09	2009-10	2010-11	2011-12
		Approved %	Revised %	Estimate %	Estimate %	Estimate %
No. 9	**Upper Limit for Fixed Interest Rate Exposure**	100%	100%	100%	100%	100%
No. 10	**Upper Limit for Variable Rate Exposure**	100%	100%	100%	100%	100%

9.3 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%

10.3 As the Council currently has no outstanding long-term borrowing, the limits above provide the necessary flexibility within which decisions will be made for drawing down new fixed rate loans.

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 upper limit for 2008-09 was set to permit the Council's two fund managers the flexibility to operate within their individual fund mandates. The lower thresholds for 2009-10 onwards reflect the Council's diminishing investment balances.

No. 12	**Upper Limit for total principal sums invested over 364 days**	2008-09	2008-09	2009-10	2010-11	2011-12
		Approved £m	Revised £m	Estimate £m	Estimate £m	Estimate £m
		16.0	**16.0**	**3.0**	**3.0**	**3.0**

APPENDIX B

Arlingclose's Forecast for Interest Rates (December 2008)

	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
Official Bank Rate									
Upside risk							+0.25	+0.25	+0.25
Central case	1.00	1.00	1.00	1.00	1.00	1.50	2.00	2.50	2.50
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.50	-0.50	-0.50	-0.50
1-yr LIBID									
Upside risk									
Central case	2.50	1.75	1.50	1.50	1.50	1.75	2.00	2.75	3.00
Downside risk	-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
5-yr gilt									
Upside risk									
Central case	3.00	2.75	2.50	2.00	2.00	2.50	2.75	3.00	4.00
Downside risk		-0.50	-0.50	-0.50	-0.50	-0.50			
10-yr gilt									
Upside risk									
Central case	3.40	3.10	3.00	3.00	3.00	3.50	3.75	4.00	4.50
Downside risk	-0.25	-0.25	-0.50	-0.50	-0.50	-0.50			
20-yr gilt									
Upside risk		+0.10	+0.10	+0.10	+0.10	+0.10			
Central case	4.00	4.00	4.00	4.25	4.25	4.50	4.75	4.75	4.75
Downside risk		-0.10	-0.10	-0.10	-0.10	-0.10			
50-yr gilt									
Upside risk	+0.10	+0.10	+0.10	+0.10	+0.10	+0.10	+0.10	+0.10	+0.10
Central case	3.90	3.90	4.00	4.00	4.25	4.50	4.50	4.50	4.50
Downside risk	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10

- The inflationary threats of 2008 turn into the deflationary reality of 2009. Central Banks under pressure to reduce rates decisively – even to zero or near-zero – to avoid the perils of a destructive and prolonged recession.
- The downturn in the UK gathers pace and the economy contracts for much of 2009. Prospects for Bank of England "Quantitative easing" increasingly likely**.**
- Pension, hedge and insurance fund values struggle and lead to enhanced demand for longer dated gilts.

Underlying assumptions

- Despite central bank intervention to raise bank capital and improve liquidity, conditions in money and credit markets remain very difficult as banks' lending behaviour changes fundamentally.
- Consumer spending and business investment stall, hampered by the credit drought.
- Falling house prices compel households to review savings levels and repair balance sheets (where possible).
- Commodity prices continue to fall. CPI is projected to fall below the MPC's 1% lower threshold in 2009, providing some relief for the overstretched consumer, but eroding debt burdens more slowly.
- Fear of rising unemployment dampens confidence and any prospect of sizeable wage demands.
- UK public finances are in horrid shape and will worsen as the recession bites, resulting in a slew of gilt issuance in 2009. This will ultimately push gilt yields higher, although not aggressively so.
- Global growth and activity continue to weaken. The Federal Reserve has already cut rates to a range between 0% and 0.25% and has engaged in 'quantitative easing'. The ECB could bring rates down to 2% as European economies struggle with falling domestic and international demand.

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
- AAA-rated Money Market Funds with a Constant Net Asset Value (Constant NAV) investing predominantly in government securities
- AAA-rated Money Market Funds with a Constant Net Asset Value (Constant NAV) investing in instruments issued primarily by financial institutions;
- 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) 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 short-term ratings of: P-1 (Moody's) or A-1 (S&P) or F1 (Fitch) backed up by a support rating of 1, 2 or 3 as stated in the Council's Treasury Management Practices. The individual counterparty limit for banks and building societies will be £3m; if uncertain market conditions necessitate the use of a much smaller, restricted subset of the Council's lending list, the Head of Financial Services will propose an amendment to the limit to accommodate the use of the smaller number of institutions.

Investments with the DMADF are guaranteed by HM Treasury. Following advice from the Council's treasury advisor, from a credit perspective no upper £ limit is proposed on investments with the DMADF

The Council will also take into account information on corporate developments of 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

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.