

**Manchester City Council
Report for Resolution**

Report To: Resources and Governance Overview and Scrutiny Committee –
10 February 2011

Subject: Treasury Management Strategy Statement & Borrowing Limits
and Annual Investment Strategy 2011-12

Report of: City Treasurer

Summary

To set out the proposed Treasury Management Strategy Statement and Borrowing Limits for 2011-12 and Prudential Indicators for 2011-12 to 2013-14.

Recommendations

To note the proposed Treasury Management Strategy Statement:-

- The Treasury Indicators listed in Appendix A of this report.
- The MRP Strategy outlined in Appendix B.
- The revised Treasury Management Policy Statement at Appendix C
- The Borrowing Requirements listed in section 4.
- The Borrowing Strategy outlined in section 7.
- The Annual Investment Strategy detailed in section 8.

Subject to the comments of the Committee the Treasury Management Strategy as contained in this report will be sent to Executive for approval on 16 February as part of the budget report.

Wards Affected:

Not Applicable

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Background documents (available for public inspection):

Reports by Sector Treasury Services (Treasury Advisors)

1. Introduction

1.1. Background

Treasury management is defined as:

“The management of the local authority’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”

1.2. Statutory requirements

The Local Government Act 2003 (the Act) and supporting regulations requires the Council to ‘have regard to’ the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council’s capital investment plans are affordable, prudent and sustainable.

The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance subsequent to the Act and included as paragraph 8.6 of this report); this sets out the Council’s policies for managing its investments and for giving priority to the security and liquidity of those investments.

The Department of Communities and Local Government has issued revised investment guidance which came into effect from the 1st of April 2010. There were no major changes required over and above the changes already required by the revised CIPFA Treasury Management Code of Practice 2009.

1.3. CIPFA requirements

The Chartered Institute of Public Finance and Accountancy’s (CIPFA) Code of Practice on Treasury Management (Revised November 2009) was adopted by this Council on the 3rd of March 2010, having been approved by Executive on the 10th of February 2010.

The primary requirements of the Code are as follows:

- a) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council’s treasury management activities;
- b) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives;
- c) Receipt by the full council of an annual Treasury Management Strategy Statement – including the Annual Investment Strategy and Minimum Revenue Provision Policy – for the year ahead, a Mid-year Review Report and an Annual Report covering activities during the previous year;
- d) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions;
- e) Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this

Council the delegated body is the Resource and Governance Overview and Scrutiny Committee.

1.4. Treasury Management Strategy for 2011/12

The suggested strategy for 2011/12 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor, Sector Treasury Services.

The strategy covers:

Section 1:	Introduction
Section 2:	Treasury Limits for 2011/12 to 2013/14
Section 3:	Current Portfolio Position
Section 4:	Borrowing Requirement
Section 5:	Prudential and Treasury Indicators for 2011/12 to 2013/14
Section 6:	Prospects for Interest Rates
Section 7:	Borrowing Strategy
Section 8:	Annual Investment Strategy
Section 9:	MRP Strategy
Section 10:	Recommendations
Appendix A:	List of Prudential and Treasury Indicators for approval
Appendix B:	MRP Strategy
Appendix C:	Treasury Management Policy Statement
Appendix D:	Treasury Management Scheme of Delegation
Appendix E:	The Treasury Management Role of the Section 151 Officer
Appendix F:	Economic Background
Appendix G:	Prospects for Interest Rates
Appendix H:	Glossary of Terms

1.5. Balanced Budget Requirement

It is a statutory requirement under Section 33 of the Local Government Finance Act 1992 for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from:

- increases in interest charges caused by increased borrowing to finance additional to capital expenditure; and
- any increases in running costs from new capital projects are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

2. Treasury Limits for 2011/12 to 2013/14

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

- 2.2. The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is acceptable.
- 2.3. Whilst termed and “Affordable Borrowing Limit”, the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years; details of the Authorised Limit can be found in appendix A of this report.

3. Current Portfolio Position

- 3.1. It is forecast that the Council's treasury portfolio position at 31 March 2011 will comprise:

Table 1		Principal		Ave. rate
		£'000	£'000	%
Fixed rate funding	PWLB	200,294		3.98
	Market	358,250		4.79
	Stock	8,186		3.37
			566,730	
Variable rate funding	PWLB	0		
	Market	191,390		5.07
			191,390	
Other long term liabilities			0	
Gross debt			758,120	4.63
Investments			(56,777)	0.53
Net debt			701,343	4.96

4. Borrowing Requirement

- 4.1. The potential long-term borrowing requirements over the next three years are as follow:

Table 2	2011/12	2012/13	2013/14
	£'000	£'000	£'000
	estimate	estimate	estimate
Potential New Borrowing	158,175	90,996	27,584

5. Prudential and Treasury Indicators for 2011/12 to 2013/14

- 5.1. Prudential and Treasury Indicators (as set out in Appendix A to this report) are relevant for the purpose of setting an integrated treasury management strategy.
- 5.2. The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The original 2001 Code was adopted on the 8th of October 2003 by the full Council, and the revised 2009 code was adopted on the 3rd of March 2010.

6. Prospects for Interest Rates

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

Sector Bank Rate forecast for financial year ends (March)

- 2011: 0.50%
- 2012: 1.00%
- 2013: 2.25%
- 2014: 3.25%

- 6.2. There is a downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected. There is also a risk that the MPC could decide to start raising Bank Rate in quarter 3 of 2011 if it feels it needs to defend its credibility in containing inflation and the inflation expectations of the public. This upside risk could also become evident if the recovery is much stronger than expected. A detailed view of the current economic background is contained within Appendix F to this report.

7. Borrowing Strategy

7.1. Borrowing rates

The Sector forecast for the PWLB new borrowing rate is as follows:

	Mar 11	Jun 11	Sep 11	Dec 11	Mar 12	Mar 13	Mar 14
Bank Rate	0.5%	0.50%	0.50%	0.75%	1.00%	2.25%	3.25%
5 yr PWLB rate	3.30%	3.30%	3.40%	3.50%	3.60%	4.30%	5.00%
10 yr PWLB rate	4.40%	4.40%	4.40%	4.50%	4.70%	5.10%	5.40%
25 yr PWLB rate	5.20%	5.20%	5.20%	5.30%	5.30%	5.50%	5.70%
50 yr PWLB rate	5.20%	5.30%	5.20%	5.30%	5.30%	5.50%	5.70%

A more detailed Sector forecast is included in Appendix G to this report.

- 7.2. The outcomes of the proposed HRA reform may have a significant effect on the treasury management position of the Council. The full details of the reform are still unknown, and therefore it is difficult to take account of the potential changes in this strategy. In the event of the authority needing to borrow officers will evaluate all available options based on what is known at the time. For the coming year the strategy will need to be flexible as circumstances unfold.
- 7.3. The Council's borrowing strategy will give consideration to new borrowing in the following forms:
- a) The cheapest borrowing will be internal borrowing by running down cash balances and foregoing interest earned at historically low rates. However, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing the short term advantage of internal borrowing against potential long term costs if the opportunity is missed for taking market loans at long term rates which will be higher in future years;
 - b) PWLB variable rate loans for up to 10 years;
 - c) Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintaining an appropriate balance between PWLB and market debt in the debt portfolio;
 - d) PWLB borrowing for period under 10 years where rates are expected to be significantly lower than rates for longer periods. This offers a range of options for new borrowing which will spread debt maturities away from a concentration in longer dated debt;
 - e) Rates are expected to gradually increase during the year so it should therefore be advantageous to time new borrowing for the start of the year.

However, these types of borrowing will need to be evaluated alongside their availability. In particular, there is a very limited availability of traditional market loans, with those available tending to be LOBOs which do not provide the required degree of certainty regarding the long-term interest rates payable on the loans. In the light of this, the Council will be exploring the use of bond placements to raise funding, possibly working alongside other local authorities to share costs. Issuing bonds would give the Council greater control over the long term interest rates on its borrowing.

7.4. Sensitivity of the forecast

In normal circumstances the main sensitivities of the forecast are likely to be the two scenarios noted below. The Council officers, in conjunction with the treasury advisors, will continually monitor both the prevailing interest rates and the market forecast, adopting the following responses to a change of sentiment:

- *If it were felt that there was a significant risk of a sharp FALL in long and short term rates, e.g. due to a marked increase of risks around relapse*

into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- *if it were felt that there was a significant risk of a much sharper RISE in long and short term rates than that current forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.*

7.5. External v. internal borrowing

There is currently a difference of around £100m between the Council's gross debt and net debt (i.e. the gross debt after deducting cash balances), although this is expected to fall to around £50m by the end of the financial year.

The current borrowing position reflects the historic strong balance sheet of the council. It enables net interest costs to be minimised and reduces credit risk by making temporary use of internal borrowing (reserves, provisions, positive cash flows, etc). Although some new borrowing has been taken in 2010/11 the policy remains to keep cash as low as possible and minimise temporary investments.

The next financial year is expected to be one of historically abnormally low Bank Rate. This provides a continuation of the current window of opportunity for local authorities to fundamentally review their strategy of undertaking new external borrowing.

Over the next three years, investment rates are therefore expected to be below long term borrowing rates and so value for money considerations would indicate that value could best be obtained by avoiding new external borrowing and by using internal cash balances to finance new capital expenditure or to replace maturing external debt (this is referred to as internal borrowing). This would maximise short term savings.

However, short term savings by avoiding new long term external borrowing in 2011/12 will also be weighed against the potential for incurring additional long term extra costs by delaying unavoidable new external borrowing until later years when PWLB long term rates are forecast to be significantly higher.

The Council has examined the potential for undertaking early repayment of some external debt to the PWLB in order to reduce the difference between its gross and net debt positions. However, the introduction by the PWLB of significantly lower repayment rates than new borrowing rates in November 2007, which has now been compounded since the 20th of October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has meant that large premiums would be incurred by such action and would also do so in the near term; such levels of premiums cannot be justified on value for money grounds. This situation will be monitored in case these differentials are narrowed by the PWLB at some future date.

Against this background caution will be adopted within the 2011/12 treasury operations. The City Treasurer will monitor the interest rate market and adopt

a pragmatic approach to changing circumstances, reporting any decisions to the appropriate decision making body at the next available opportunity.

7.6. Policy on borrowing in advance of need

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

In determining whether borrowing will be undertaken in advance of need the Council will:

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt profile which supports the need to take funding in advance of need;
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered;
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;
- consider the merits and demerits of alternative forms of funding;
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use; and
- consider the impact of borrowing in advance temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

7.7. Debt rescheduling

The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt, which has now been compounded since the Comprehensive Spending Review on the 20th of October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has meant that PWLB to PWLB debt restructuring is now much less attractive than it was before both of these events. In particular, consideration would have to be given to the large premiums which would be incurred by prematurely repaying existing PWLB loans and it is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing. However, some interest savings might still be achievable through using LOBO (Lenders Option Borrowers Option) loans, and other market loans, in rescheduling exercises rather than using PWLB borrowing as the source of replacement financing.

As short term borrowing rates will be considerably cheaper than longer term rates, there may be potential for some residual opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the size of the premiums incurred, their short term nature, and the likely cost of refinancing those short term loans once they mature, compared to the current rates of longer term debt in the existing debt portfolio. Any such rescheduling and repayment of

debt is likely to cause a flattening of the Council's maturity profile as in recent years there has been a skew towards longer dated PWLB.

The reasons for any rescheduling to take place will include:-

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the strategy outlined in paragraph 7.3 above;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility)

Consideration will also be given to identify if there is any residual potential left for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

There is potential, depending on the final outcome of the proposed HRA reform, for all of our PWLB debt to be repaid by the Government as part of the HRA settlement. The proposed date for the reform is the 1st of April 2012, so although it does not directly impact on the period covered by this strategy statement officers will, throughout the year, investigate ways of managing the impact of the outcome of HRA reform on the treasury management position of the Council, to ensure that the authority continues to minimise the cost of the debt it holds.

All rescheduling will be reported to the Executive, as part of the normal revenue budget monitoring.

8. Annual Investment Strategy

8.1. The Council will have regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are:-

- a) the security of capital; and
- b) the liquidity of its investments.

The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investments.

The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

These principles would be important in normal circumstances, but the Icelandic banks crisis, and the financial difficulties faced by UK and international banks that followed, have placed security of investments at the forefront of Treasury Management investment policy.

In order to achieve a higher level of security the City Treasurer has introduced a number of measures:-

- Investments to be restricted to UK banks, building societies, local authorities and UK Government institutions. If, as the year progresses, the Council needs to spread its counterparty risk by identifying more

counterparties than currently operate in the UK, the Treasurer may seek approval to remove this restriction, so that non-UK institutions can be considered as counterparties. Any proposal to do this, along with restrictions in the proposed use of non-UK banks will be reported to members for approval before any deposits are made.

- Diversify the investment portfolio into more secure UK Government and Government-backed investment instruments.
- Although the current investment strategy allows investments up to 364 days, restrict deposits to as short a time period as feasible.

There is a price to pay for an increased level of security. Greater security, and reduced exposure to risk, can only be achieved at the cost of lower rates of return.

8.2. Specified and Non-Specified Investments

Investment instruments identified for use in the financial year are listed below, and are all specified investments. Any proposals to use other non-specified investments will be reported to members for approval.

Specified Investments

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

	Minimum 'High' Credit Criteria	Use
Term deposits – banks and building societies*	See below.	In-house
Term deposits – other Local Authorities	High security. Only one or two local authorities credit-rated	In-house
Debt Management Agency Deposit Facility	UK Government backed	In-house
UK Nationalised Banks	UK Government backed	In-house
Certificates of deposits issued by banks and building societies covered by UK Government guarantees	UK Government explicit guarantee	In-house

* Banks

Have as a minimum the following Fitch (or equivalent) credit ratings (where rated):

- Long Term – Fitch A
- Short Term – Fitch F1
- Support – Fitch 3

Building Societies

Have as a minimum the following Fitch (or equivalent) credit ratings (where rated):

- a) Long Term – Fitch A-
- b) Short Term – Fitch F2
- c) Support – Fitch 3

The City Council's own banker, if the bank falls below the above criteria, although balances will be kept below £5 million and be invested for less than 7 days. Please note this relates to specific investments and not balances held within the Council's general bank accounts.

** The original list of banks covered when the support package was initially announced was:-

- Abbey (now part of Santander)
- Barclays
- HBOS (now part of Lloyds Group)
- Lloyds TSB
- HSBC
- Nationwide Building Society
- RBS
- Standard Chartered

Banks eligible for support under the UK bail-out package and which have issued debt guaranteed by the Government are eligible for a continuing Government guarantee when debt issues originally issued and guaranteed by the Government mature and are refinanced. However, no other institutions can make use of this support as it closed to new issues and entrants on the 28th of February 2010. The banks which have used this explicit guarantee are as follows:-

- Bank of Scotland
- Barclays
- Clydesdale
- Coventry Building Society
- Investec Bank
- Nationwide Building Society
- Rothschild Continuation Finance plc
- Standard Life Bank
- Tesco Personal Finance plc
- Royal Bank of Scotland
- West Bromwich Building Society
- Yorkshire Building Society

8.3. Creditworthiness policy

The Council uses the creditworthiness service provided by Sector. This service has been progressively enhanced over the last year and now uses a sophisticated modelling approach with credit ratings from all three rating agencies – Fitch, Moodys and Standard & Poors, forming the core element.

However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:

- Credit watches and credit outlooks from credit rating agencies
- CDS spreads to give early warning of likely changes in credit ratings
- Sovereign ratings to select counterparties from only the most creditworthy countries

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments and are therefore referred to as durational bands. The Council is satisfied that this service now gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.

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

- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months

This Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties as Moodys tend to be more aggressive in giving low ratings than the other two agencies. This would therefore be unworkable and leave the Council with few banks on its approved lending list. The Sector creditworthiness service does, though, use ratings from all three agencies, but by using a risk weighted scoring system does not give undue preponderance to just one agency's ratings.

All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

- If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- In addition to the use of Credit Ratings, the Council will be advised of information in Credit Default Swap against the iTraxx benchmark¹ and other market data on a weekly basis. Extreme market movements may

¹ The Markit iTraxx Senior Financials Index is a composite of the 25 most liquid financial entities in Europe. The index is calculated through an averaging process by the Markit Group and is used as the benchmark level of CDS spreads on Sector's Credit List.

result in the downgrade of an institution or removal from the Council's lending list.

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

8.4. Investment Limits

As advised by Sector, our treasury advisors, the financial investment limits of banks and building societies are linked to their Fitch long-term ratings (or equivalent) as follows:-

Banks

Fitch AA+	£20 million
Fitch AA/AA-	£15 million
Fitch A+/A	£10 million

Building Societies

Fitch AA/AA-	£15 million
Fitch A+/A-	£10 million
Debt Management Office	£100 million
District Councils	£5 million
Other Local Authorities	£10 million

8.5. Liquidity

Based on cash flow forecasts, the level of cash balances in 2011/12 is estimated to range between £ 0m and £ 160m. The higher level can arise where, for instance, large government grants are received or long term borrowing has recently been undertaken.

Giving due consideration to the Council's level of balances over the next year, the need for liquidity, its spending commitments and provisioning for contingencies, it is considered very unlikely that the Council will have cash balances to invest other than on a temporary basis. For this reason, no cash will be held on term deposit maturities in excess of 1 year.

8.6. Investment Strategy to be followed in-house

Bank rate has been unchanged at 0.50% since March 2009. Bank rate is forecast to commence rising in quarter 3 of 2010 and then rise steadily from thereon. Bank Rate forecasts for financial year ends (March) are as follows:-

- 2010/11: 0.50%
- 2011/12: 1.00%
- 2012/13: 2.25%
- 2013/14: 3.25%

There is a downside risk to these forecasts if economic growth is weaker than expected. There is also a risk that the MPC could decide to start raising Bank

Rate before quarter 3 of 2011 if it feels the need to defend its credibility in containing inflation and the inflation expectations of the public.

The Council will avoid locking into longer term deals while investment rates are down at historically low levels unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile and within the risk parameters set by this Council.

For 2011/12 it is suggested that the Council should budget for an investment return of 0.70% on investments placed during the financial year.

For cash flow generated balances, the Council will seek to utilise its business reserve accounts and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

It should be noted there is a significant risk to the rate of return available through the Council's call accounts, because the Financial Services Agency is considering enforcing a liquidity buffer on banks to mitigate against the risk of any shocks to the financial system. The current proposals include forcing banks to make provision to fully match any callable local authorities balances they hold with liquid assets, to ensure that councils are always able to withdraw their deposits. This will have a substantial adverse impact on the interest rate banks will be able to offer on local authorities call accounts. Should this event arise, to protect the current level of return, officers may seek to revise the annual investment strategy, subject to approval from members.

8.7. End of year Investment Report

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

8.8. Policy on the use of external service providers

The Council uses Sector Treasury Services as its external treasury management advisors. In previous years Butlers were also used, but they have now been bought by Sector.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

8.9. Scheme of delegation

Please see Appendix D for the responsibilities of member groups and officers in relation to treasury management.

8.10. Role of the Section 151 officer

Please see Appendix E for the definition of the role of the City Treasurer in relation to treasury management.

9. Minimum Revenue Provision (MRP) Strategy

9.1. Please see Appendix B for the Council's policy for spreading capital expenditure charge to revenue through the annual MRP charge.

10. Recommendations

10.1. Please see the front of the report for the list of recommendations.

Appendix A

List of Treasury Indicators for approval

Please note last years approved figures are shown in brackets

Treasury management indicators	2011/12		2012/13		2013/14
	£m		£m		£m
Authorised Limit for external debt -					
borrowing	1,139	(1,132)	1,103	(1,200)	1,103
other long term liabilities (note 1)	168	(206)	161	(206)	156
TOTAL	1,307	(1,338)	1,264	(1,406)	1,259
Operational Boundary for external debt -					
borrowing	1,050	(1,059)	1,071	(1,132)	1,092
other long term liabilities (note 1)	168	(206)	161	(206)	156
TOTAL	1,218	(1,265)	1,232	(1,338)	1,248
Actual external debt	£m		£m		£m
	917		1,008		1,035
Upper limit for fixed interest rate exposure					
Net borrowing at fixed rates as a % of total net borrowing	96%	(85%)	100%	(86%)	100%
Upper limit for variable rate exposure					
Net borrowing at Variable rates as a % of total net borrowing	48%	(65%)	70%	(74%)	78%
Upper limit for total principal sums invested for over 364 days	£m		£m		£m
	0	(0)	0	(0)	0

Maturity structure of new fixed rate borrowing during 2011/12	Upper Limit		Lower limit	
under 12 months	40%	(50%)	0%	(0%)
12 months and within 24 months	70%	(60%)	20%	(0%)
24 months and within 5 years	60%	(80%)	0%	(30%)
5 years and within 10 years	50%	(60%)	0%	(0%)
10 years and above	60%	(60%)	30%	(10%)

Appendix B

Minimum Revenue Policy Strategy

The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2009/10 and will assess its MRP for 2011/12 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

The Council is required to make provision for repayment of an element of the accumulated General Fund capital spend each year through a revenue charge (the Minimum Revenue Provision - MRP).

CLG Regulations require full Council to approve an MRP Statement. This will need to be approved in advance of each year. If the Council wishes to amend its policy during the year this would need to be approved by full Council. A variety of options were provided to councils to replace the previous Regulations, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:-

For non HRA supported capital expenditure, MRP policy will continue to be charged at a rate of 4% in accordance with option 1 of the guidance (the regulatory method).

For non HRA unsupported capital expenditure incurred the MRP policy will be:

Asset Life Method – MRP will be based on a straight line basis or annuity method so linking the MRP to the future flow of benefits from the asset, dependant on the nature of the capital expenditure, in accordance with option 3 of the guidance. The MRP will start in the year after the capital expenditure is incurred or, in the case of new assets, in the year following the asset coming into use, in accordance with the guidance.

For non HRA capital expenditure funded by borrowing in relation to expenditure which is capital by virtue of a Ministerial direction, or is capital expenditure which does not create a council asset, MRP will be provided as follows, starting in the year after the capital expenditure is incurred or, in the case of new assets, in the year following the asset coming into use, in accordance with the guidance.

This will also apply for any expenditure capitalised under a Capitalisation Directive.

Expenditure type	Maximum period over which MRP to be made
Expenditure capitalised by virtue of a direction under s16 (2) (b).	20 years.
Regulation 25(1) (a). Expenditure on computer programs.	Same period as for computer hardware.
Regulation 25(1) (b). Loans and grants towards capital expenditure by third parties.	The estimated life of the assets in relation to which the third part expenditure is incurred.
Regulation 25(1) (c). Repayment of grants and loans for capital expenditure.	25 years or the period of the loan if longer.

Regulation 25(1) (d). Acquisition of share or loan capital.	20 years.*
Regulation 25(1) (e). Expenditure on works to assets not owned by the authority.	The estimated life of the assets.
Regulation 25(1) (ea). Expenditure on assets for use by others.	The estimated life of the assets.
Regulation 25(1) (f). Payment of levy on Large Scale Voluntary Transfers (LSVTs) of dwellings.	25 years.

* The recommended policy is in line with the guidance, but it is recommended that the policy in relation to Regulation 25(1) (d) items should be amended to equal the estimated life of assets associated with the acquisition expenditure.

Following the move to International Accounting Standards arrangements under private finance initiatives (PFIs) service concessions and some lessee interests (including embedded leases) are now accounted for on the Council's balance sheet. Where this happens, a part of the contract charge or rent payable will be taken to reduce the balance sheet liability rather than being charged as revenue expenditure. The MRP element of these schemes will be the amount of contract charge or rental payment now charged against the balance sheet liability. This approach will produce an MRP charge comparable to that under option 3 in that it will run over the life of the lease or PFI scheme.

Appendix C

Treasury Management Policy Statement

1. This organisation defines its treasury management activities as: “The management of the authority’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks”.
2. This organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.
3. This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

Appendix D

Treasury management scheme of delegation

(i) Full council

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

(ii) Responsible body – Audit Committee

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices
- budget consideration and approval
- approval of the division of responsibilities
- receiving and reviewing regular monitoring reports and acting on recommendations
- approving the selection of external service providers and agreeing terms of appointment.

(iii) Body with responsibility for scrutiny - Resource and Governance Overview and Scrutiny Committee

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

(iv) City Treasurer

- Delivery of the function

Appendix E

The treasury management role of the section 151 officer

The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers.

Appendix F

Economic Background

1. Global economy

The sovereign debt crisis peaked in May 2010 prompted, in the first place, by major concerns over the size of the Greek government's total debt and annual deficit. However, any default or write down of Greek debt would have substantial impact on other countries, in particular, Portugal, Spain and Ireland. This crisis culminated in the EU and IMF putting together a €750bn support package in mid May. A second crisis, this time over Ireland in November, culminated in Ireland also having to take a bail out. By early January 2011, there is major concern that Portugal will also shortly need to take a bail out. That, in turn, would then stoke major concerns as to whether the current size of the bail out facility put together by the EU and IMF would be big enough to cope with any crisis that then blew up over Spanish government debt.

The unexpectedly high rate of growth in quarters 2 and 3 of 2010 in the UK and the Euro zone in Q2 were driven by strong growth in the construction sector catching up from inclement weather earlier in the year and by other short term factors not expected to be enduring; general expectations are for anaemic (but not negative) growth in 2011 in the western world.

2. UK economy

Following the general election in May 2010, the coalition government has put in place an austerity plan to carry out correction of the public sector deficit over the next five years. The inevitable result of fiscal contraction will be major job losses during this period, in particular in public sector services. This is likely to have a knock on effect on consumer and business confidence and appears to have also hit the housing market as house prices started on a negative trend during the summer and autumn of 2010. Mortgage approvals are also at very weak levels and declining, all of which indicates that the housing market is likely to be very weak in 2011.

Economic Growth – GDP growth is likely to have peaked in the current period of recovery at 1.2% in quarter 2 of 2010. Growth in quarter 3 of +0.7% was also unexpectedly high. However, the outlook is for anaemic growth in 2011/12 although the Bank of England and the Office for Budget Responsibility are forecasting near trend growth (2.5%) i.e. above what most forecasters are currently expecting.

Unemployment – the trend of falling unemployment (on the benefit claimant count) has now been replaced since July 2010 with small increases which are likely to be the start of a new trend for some years ahead of rising unemployment.

Inflation and Bank Rate – CPI has remained high during 2010. It peaked at 3.7% in April and has gradually declined to 3.1% in September (RPI 4.6%). However, the outlook from there is a rising trend which could even reach as much as 4% in early 2011 before starting to subside again. Although inflation has remained stubbornly above the MPC's 2% target, the MPC is confident that inflation will fall back under the target over the next two years.

The Bank of England finished its programme of quantitative easing (QE) with a total of £200bn in November 2009. However, major expectation that there could be a second round of quantitative easing in late 2010 or early 2011, to help support

economic growth, has evaporated after the surprises of the Q3 GDP figure of +0.7% and the November Inflation Report revising the forecast for short term inflation sharply upwards.

Sector's view is that there is unlikely to be any increase in Bank Rate until the end of 2011.

AAA rating – prior to the general election, credit rating agencies had been issuing repeated warnings that unless there was a major fiscal contraction, then the AAA sovereign rating was at significant risk of being downgraded. Sterling was also under major pressure during the first half of the year. However, after the Chancellor's budget on 22 June, Sterling strengthened against the US dollar and confidence has returned that the UK will retain its AAA rating. In addition, international investors now view UK government gilts as being a safe haven from EU government debt. The consequent increase in demand for gilts helped to add downward pressure on gilt yields and PWLB rates.

3. Sector's forward view

It is currently difficult to have confidence as to exactly how strong the UK economic recovery is likely to be during 2011/12, and there are a range of views in the market. Sector has adopted a moderate view. There are huge uncertainties in all forecasts due to the major difficulties of forecasting the following areas:

- the speed of economic recovery in our major trading partners - the US and EU
- the danger of currency war and resort to protectionism and tariff barriers if China does not address the issue of its huge trade surplus due to its undervalued currency
- the degree to which government austerity programmes will dampen economic growth and undermine consumer confidence
- changes in the consumer savings ratio
- the speed of rebalancing of the UK economy towards exporting and substituting imports
- the potential, in the US, for more quantitative easing, and the timing of this, and its subsequent reversal in both the US and UK
- the speed of recovery of banks' profitability and balance sheet imbalances and the consequent implications for the availability of credit to borrowers
- the potential for a major EU sovereign debt crisis which could have a significant impact on financial markets and the global and UK economy
- political risks in the Middle East and Korea

The overall balance of risks is weighted to the downside and there is some risk of a double dip recession and deleveraging, creating a downward spiral of falling demand, falling jobs and falling prices, although this is currently viewed as being a small risk.

Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries.

Appendix G

Prospects for Interest Rates

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

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

1. INDIVIDUAL FORECASTS

Sector interest rate forecast – 6/1/11

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14
Bank rate	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%	2.25%	2.75%	3.00%	3.25%	3.25%
3 month LIBID	0.60%	0.70%	0.80%	1.00%	1.25%	1.50%	1.75%	2.00%	2.50%	3.00%	3.25%	3.50%	3.50%
6 month LIBID	0.90%	1.00%	1.10%	1.20%	1.50%	1.80%	2.10%	2.40%	2.80%	3.20%	3.50%	3.80%	4.00%
12 month LIBID	1.40%	1.50%	1.60%	1.80%	2.10%	2.40%	2.70%	3.00%	3.20%	3.40%	3.65%	4.00%	4.20%
5yr PWLB rate	3.30%	3.30%	3.40%	3.50%	3.60%	3.80%	3.90%	4.10%	4.30%	4.60%	4.80%	4.90%	5.00%
10yr PWLB rate	4.40%	4.40%	4.40%	4.50%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.30%	5.40%	5.40%
25yr PWLB rate	5.20%	5.20%	5.20%	5.30%	5.30%	5.40%	5.40%	5.40%	5.50%	5.50%	5.60%	5.70%	5.70%
50yr PWLB rate	5.20%	5.20%	5.20%	5.30%	5.30%	5.40%	5.40%	5.40%	5.50%	5.50%	5.60%	5.70%	5.70%

Capital Economics interest rate forecast – 12/1/11

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.50%	2.00%
5yr PWLB rate	3.20%	3.20%	3.00%	2.75%	2.75%	2.90%	3.00%	3.20%	3.40%	3.60%	3.90%	4.20%
10yr PWLB rate	4.75%	4.75%	4.25%	3.75%	3.75%	3.75%	3.75%	3.75%	3.90%	4.00%	4.30%	4.60%
25yr PWLB rate	5.25%	5.25%	4.85%	4.65%	4.65%	4.65%	4.65%	4.65%	4.75%	4.85%	5.10%	5.30%
50yr PWLB rate	5.30%	5.30%	5.20%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.10%	5.20%	5.30%

UBS interest rate forecast (for quarter ends) – 6/1/11

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
Bank rate	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%	2.00%
10yr PWLB rate	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%
25yr PWLB rate	5.25%	5.30%	5.35%	5.40%	5.45%	5.50%	5.55%	5.60%
50yr PWLB rate	5.35%	5.40%	5.45%	5.50%	5.55%	5.60%	5.65%	5.70%

HM Treasury December 2010

The current Q4 2010 and 2011 forecasts are based on the December 2010 report. Forecasts for 2010 – 2014 are based on 32 forecasts in the last quarterly forecast – in November 2010.

BANK RATE FORECASTS	quarter ended			annual average Bank Rate			
	actual	Q4 2011		ave. 2011	ave. 2012	ave. 2013	ave. 2014
Median	0.50%	2.00%		0.90%	1.60%	2.40%	3.00%
Highest	0.50%	0.50%		2.10%	3.10%	3.60%	4.50%
Lowest	0.50%	0.80%		0.50%	0.50%	0.60%	1.20%

Appendix H

Glossary of Terms

Authorised Limit - This Prudential Indicator represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable. It is the expected maximum borrowing need, with some headroom for unexpected movements.

Bank Rate – the rate at which the Bank of England offers loans to the wholesale banks, thereby controlling general interest rates in the economy.

Counterparty – one of the opposing parties involved in a borrowing or investment transaction

Credit Rating – A qualified assessment and formal evaluation of an institution's (bank or building society) credit history and capability of repaying obligations. It measures the probability of the borrower defaulting on its financial obligations, and its ability to repay these fully and on time.

Discount – Where the prevailing interest rate is higher than the fixed rate of a long-term loan, which is being repaid early, the lender can refund the borrower a discount, the calculation being based on the difference between the two interest rates over the remaining years of the loan, discounted back to present value. The lender is able to offer the discount, as their investment will now earn more than when the original loan was taken out.

Fixed Rate Funding - A fixed rate of interest throughout the time of the loan. The rate is fixed at the start of the loan and therefore does not affect the volatility of the portfolio, until the debt matures and requires replacing at the interest rates relevant at that time.

Gilts - The loan instruments by which the Government borrows. Interest rates will reflect the level of demand shown by investors when the Government auctions Gilts.

High/Low Coupon – High/Low interest rate

Liquidity – The ability of an asset to be converted into cash quickly and without any price discount. The more liquid a business is, the better able it is to meet short-term financial obligations.

Market - The private sector institutions - Banks, Building Societies etc.

Maturity Profile/Structure - an illustration of when debts are due to mature, and either have to be renewed or money found to pay off the debt. A high concentration in one year will make the Council vulnerable to current interest rates in that year.

Monetary Policy Committee – the independent body that determines Bank Rate.

Operational Boundary – This Prudential Indicator is based on the probable external

debt during the course of the year. It is not a limit and actual borrowing could vary around this boundary for short times during the year. It should act as an indicator to ensure the Authorised Limit is not breached.

Premium – Where the prevailing current interest rate is lower than the fixed rate of a long-term loan, which is being repaid early, the lender can charge the borrower a premium, the calculation being based on the difference between the two interest rates over the remaining years of the loan, discounted back to present value. The lender may charge the premium, as their investment will now earn less than when the original loan was taken out.

Prudential Code - 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.

PWLB - Public Works Loan Board. Part of the Government’s Debt Management Office, which provides loans to public bodies at rates reflecting those at which the Government is able to sell Gilts.

Specified Investments - Sterling investments of not more than one-year maturity. These are considered low risk assets, where the possibility of loss of principal or investment income is very low.

Non-specified investments - Investments not in the above, specified category, e.g., foreign currency, exceeding one year or outside our minimum credit rating criteria.

Variable Rate Funding - The rate of interest either continually moves reflecting interest rates of the day, or can be tied to specific dates during the loan period. Rates may be updated on a monthly, quarterly or annual basis.

Volatility - The degree to which the debt portfolio is affected by current interest rate movements. The more debt maturing within the coming year and needing replacement, and the more debt subject to variable interest rates, the greater the volatility.

Yield Curve - A graph of the relationship of interest rates to the length of the loan. A normal yield curve will show interest rates relatively low for short-term loans compared to long-term loans. An inverted Yield Curve is the opposite of this.