

ANNEX 3

Treasury Management Strategy Statement & Borrowing Limits and Annual Investment Strategy 2009-10

1. Introduction

The Council's Treasury Management policy complies with the CIPFA Code of Practice on Treasury Management. This was adopted by the Council on 8 October 2003. In accordance with best practice, the City Treasurer has undertaken a review of the policy and is satisfied that the clauses contained therein are still relevant and complete.

The Local Government Act 2003 and supporting regulations require the Council to 'have regard to' the Prudential Code for Capital Finance in Local Authorities and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act) (included as section 10); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The proposed strategy for 2009/10 is based upon the views of Treasury officers on interest rates, informed by leading market forecasts. The report covers the following:

- Treasury limits in force;
- Prudential Indicators;
- The current treasury position of the Council;
- Borrowing Requirement;
- Housing Large Scale Voluntary Transfers (LSVTs);
- Interest rate prospects;
- Capital borrowings and the portfolio strategy;
- MRP Strategy;
- Investment strategy.

A glossary of terminology used in this report is attached in Appendix B.

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: -

1. increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
2. 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 2009/10 to 2011/12

There is a statutory duty, under section 3 of the Local Government Act 2003 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 Authorised Limit.

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/rent levels is acceptable.

The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

3. Prudential Indicators for 2009/10 – 2011/12

A requirement of the Local Government Act 2003 is that local authorities comply with the Prudential Code for Capital Finance in Local Authorities. Under the Code, various Prudential Indicators must be approved by the budget setting body, i.e., the Council. These indicators are listed in Appendix 4 to Annex 1 of this report.

4. Current Portfolio Position

The Council's estimated treasury portfolio position at 31 March 2009 will comprise:

	£000	£000	Average Rate
<u>Fixed Rate Funding</u>			
PWLB	11,597		8.87%
Market	308,250		4.88%
Stock	8,253		3.36%
		333,575	
<u>Variable Rate Funding</u>			
PWLB	0		0%
Market	241,390		4.84%
		241,390	
Temporary Borrowings		44,103	0.75%
Airport Loans		(83,255)	10.22%

5. Borrowing Requirement

The potential long-term borrowing requirements, plus alternative financing arrangements, over the next three years, are as follows:

	2009/10	2010/11	2011/12
	£000	£000	£000
Potential Long-term borrowing	249,124	132,407	48,021

2009-10 figures include the potential refinancing of £198.3m of PWLB loans, repaid early in June and July 2006 and June and July 2007, using temporary cash balances. 2009/10 and 2010/11 figures include borrowing requirements for the Building Schools for the Future programme, which had been funded by direct government grant in previous years.

In practice, given the expected interest rate differential between long-term debt (4% to 4.5%) and short-term loans (less than 1.5%), the re-borrowing of the earlier repayments is highly unlikely.

6. Housing Large Scale Voluntary Transfers (LSVTs)

In 2004-05, the City Council began the implementation of an approved three-year programme to transfer the vast majority of its Housing stock to either Housing Associations, Arms Length Management Organisations (ALMOs) or PFI control. The first two transfers took place in October 2004 and April 2005.

The agreement with the Department for Communities and Local Government (DCLG) is that they will redeem equivalent PWLB debt associated with those properties being transferred to Housing Association control.

Transfers of Housing stock on the Stockport Overspill and City South estates took place in April and June 2008 respectively.

Advice from Sector, our Treasury advisers, with regard to these two transfers, was that a pro rata reduction of each PWLB loan would be the most suitable approach. This was adopted and resulted in the Council's PWLB debt being reduced by £99.086m.

One further transfer is expected to take place in March 2009, which will complete the transfer process. The profile of debt set out at paragraph 4 above is after the final transfer / debt redemption has taken place.

7. Prospects for Interest Rates

The Council has appointed Sector Treasury Services as its treasury adviser and part of their service is to assist the Council in formulating a view on future interest rates. Appendix A draws together a number of current City forecasts for short term and longer-term fixed interest rates.

The following table gives Sector's central view:-

	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009	Q/E1 2010	Q/E2 2010	Q/E3 2010	Q/E4 2010	Q/E1 2011	Q/E2 2011	Q/E3 2011	Q/E4 2011	Q/E1 2012
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.75%	2.50%	3.25%	3.75%	4.00%
5yr PWLB rate	2.50%	2.25%	2.15%	2.15%	2.15%	2.45%	2.80%	3.15%	3.65%	3.95%	4.20%	4.45%	4.60%
10yr PWLB rate	3.10%	2.75%	2.55%	2.55%	2.55%	2.85%	3.25%	3.65%	4.15%	4.40%	4.70%	4.75%	4.85%
25yr PWLB rate	4.00%	3.95%	3.95%	3.95%	4.00%	4.15%	4.35%	4.45%	4.60%	4.85%	4.95%	5.00%	5.05%
50yr PWLB rate	3.85%	3.80%	3.80%	3.80%	3.85%	3.90%	4.00%	4.25%	4.40%	4.70%	4.80%	4.95%	5.00%

The following paragraphs follow the convention used by H.M. Treasury in its budget reports and statistics in as much as years are always calendar years, not local authority financial years, e.g., quarter 1 refers to the January to March quarter, not the first quarter of a local authority financial year (April to June).

Economic background

Introduction

- The sub prime crisis of early 2008 was replaced by the banking crisis of autumn 2008. The world banking system came near to collapse and governments around the world were forced to re-capitalise and rescue their major banks. The resulting significant decrease in lending from banks anxious to preserve capital led to economic forecasts being sharply reduced and recession priced into markets. This in turn led to sharp falls in oil and other commodity prices, with the result that inflation, which in the UK was running at over 5%, was considered less important as recession fears drove interest rate sentiment and policy. A co-ordinated global interest rate cut of 0.50% took place on 8th October 2008. Forecasts in the UK were for further sharp cuts in interest rates as recession came into view.

International

- Early in 2008, the US economy was being badly affected by the housing market slump. Interest rates were at 2% and inflation was being dragged higher by the inexorable rise in commodity prices. The ECB was very concerned about rising inflation and less about the state of the economy.

- The second quarter of 2008 was torn between inflation worries on the one hand, with oil rising towards \$150 per barrel, and the deteriorating economic outlook on the other.
- In the second and third quarters of the year, the financial crisis erupted and escalated, as the world became aware of the extent of the sub-prime fiasco and the impact it was having on institutions which had invested in these issues.
- In September, Fannie Mae/Freddie Mac (the mortgage banks) and AIG, the insurance giant, had to be bailed out by the US Federal Government.
- Then in mid September, Lehman Bros., the investment bank, was allowed to fail. This triggered a domino effect, with other banks and financial institutions having to be rescued or supported by governments around the world.
- After the collapse into receivership of the Icelandic banks in early October, other countries then started to feel the strain and a number had to approach the International Monetary Fund for support.
- Eventually, even the Asian 'Tiger' economies were affected, including India and China, and it became clear that the crisis had become a global one and no country was insulated from it.
- The financial crisis had, therefore, precipitated an economic crisis and there was a co-ordinated global interest rate cut with the US Federal Reserve (Fed), the European Central Bank (ECB) and the Bank of England's Monetary Policy Committee (MPC) all cutting rates by 0.50% on 8th October. The Fed subsequently cut rates again by 0.50% to 1% on 29th October and, again, on 16 December to a band of 0.0% to 0.25%, in an attempt to stave off the oncoming recession. Inflation was no longer considered the main problem.
- On 4th November, the USA elected Barack Obama as President with little immediate financial impact.
- The ECB reduced rates again on 6th November by 0.50% and by its biggest ever cut of 0.75% on 4 December to reach 2.5%

UK

- GDP (Gross Domestic Product): growth was already slowing in 2008 from 2007 before the full impact of the credit crunch was felt. Earlier in 2008, GDP was 2.3%, whereas, in the autumn, the figure fell back to -0.3% and was then expected to continue to be negative going into 2009.
- Wage inflation remained relatively subdued, as the Government kept a firm lid on public sector pay. Private sector wage growth was kept in check by the slowing economy.
- Growth slowed across the economy and unemployment rose throughout the year, with forecasts of 2 million unemployed by the end of the financial year and continuing to increase thereafter through 2010.
- Notwithstanding the pressures on household finances, consumer spending still continued at a reasonable level although the trend was slowing as the year progressed.

- Bank lending came to a virtual standstill in the autumn, as the credit crunch tightened its grip and various banks internationally had to be rescued, or supported, by their governments.
- The Government and Bank of England supplied massive amounts of liquidity into the banking market, in an attempt to re-ignite longer interbank lending.
- The Government took action in September, to either supply finance itself to re-capitalise some of the major clearing banks or to require the others to strengthen their capital ratios by their own capital raising efforts. This was so that these banks would be seen to have sufficient reserves to last through the coming recession with its inevitable increase in bad loans etc.
- The housing market also came to a virtual standstill, as lenders demanded larger deposits and higher fees. House sales and prices both dropped sharply.
- Government finances deteriorated, as income from taxation dropped as the economy slowed and the cost of the bailout of the banks was added to the deficit.
- U.K. equity prices declined sharply in the third and fourth quarters, as the impending recession was priced into the markets. Prices hit five year lows and volatility was extremely high.
- The story of 2008 has been the credit crunch, the banking crisis and the change in economic outlook from slow growth to outright recession. After the initial concerns about the impact of the credit crunch in the earlier part of 2008, it appeared as though the storm had been weathered. The MPC had been very concerned about Consumer Prices Index (CPI) inflation, which had been rising sharply on the back of higher commodity and food prices. Bank Rate reached a peak of 5.75% in July 2007, after which cuts of 0.25% occurred in December 2007 and February and April 2008 before the major cuts in the autumn. The economic data had been indicating a slowing economy for some while but it was not sufficiently weak to force the MPC into another cut. It was the depth of the banking crisis, pre-empted by the collapse of Lehman Bros in New York that eventually drove the MPC to cut interest rates by 0.50% on October 8th, in concert with the Fed, the ECB and other central banks. It was then appreciated that the economic downturn would be much more severe than previously thought and interest rates were subsequently slashed by 1.50% on 6 November, 1.00% on 4 December and 0.50% on 8 January 2009.
- The LIBOR spread over Bank Rate has also been a feature, and a concern, during the year. Because of the credit fears, and the reluctance of lenders to invest cash for long periods, 3 month LIBOR (London Inter Bank Offer Rate – the rate at which banks lend to each other) has been substantially higher than Bank Rate. This has meant that the MPC's power over monetary policy has been eroded by the widening of this spread between LIBOR and Bank Rate and it has, therefore, had a limited ability to bring relief to hard pressed borrowers through lower interest rates. However, the power of the Government over the semi nationalised clearing banks had considerable impact in enforcing pro rata reductions to the 1.50% Bank Rate cut in November on some borrowing rates.
- The Government has abandoned its 'golden rule' of borrowing only for investment. The pre Budget Report on 14 November revealed the Government's plans for a huge increase in Government borrowing over coming years, as a result of falling tax revenues and also due to tax cuts and increases

in Government expenditure in the short term, designed to help stimulate economic growth to counter the recession.

8. Borrowing Strategy

Latest Cash Flow projections indicate a likely deficit at the end of the current financial year, which will be funded by temporary borrowings. This, coupled with the funding requirements of the 2009/10 Capital programme, will more than likely mean that the City Council will need to undertake more permanent borrowing during the next financial year.

Current and projected low Bank Rates, however, are likely to create a major problem for authorities. Investment returns have fallen to levels around the 1% to 2% mark, but long-term borrowing levels are generally in a range between 3% and 4.5%.

The City Treasurer is proposing a borrowing strategy to address this problem, which takes advantage of PWLB Variable rate borrowing facilities. The PWLB has two types of loan available to authorities:-

- Fixed rate loans on which the rate of interest is fixed for the life of the loan.
- Variable rate loans, on which the rate of interest is variable at one, three or six monthly intervals. Once chosen by the borrower, the interest period to be linked to and the interest payment period will remain unchanged throughout the life of the loan. The Variable interest rates are at similar levels to temporary investment rates available in the Money Markets. The maximum loan period is 10 years. Additionally, authorities have the option of repaying these Variable rate loans, in full or in part, at any time before the maturity date, and replacing them with Fixed rate loans.

In an interest rate environment where long-term rates are expected to reduce in the next 12 months, the City Treasurer will look to take advantage of this facility to secure borrowing at interest levels more in line with expected investment returns. Interest rate forecasts will be monitored during the next financial year, to ensure that longer term borrowing is then undertaken at the most advantageous times.

Whilst the Council has, in the past, made substantial use of market funds, it is unlikely that these will provide a major source in the coming year. That said, alternative borrowings are being contemplated, the availability and terms of market loans will be explored.

9. Minimum Revenue Provision (MRP) Strategy

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), although it is also allowed to undertake additional voluntary payments.

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 are provided to councils to replace the existing Regulations, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:-

- For non HRA capital expenditure incurred before 1 April 2008 or which, from 1 April 2008, will be supported capital expenditure, the MRP policy will be:

- **Existing practice** - MRP will follow the existing practice outlined in former CLG Regulations.
- For non HRA capital expenditure incurred from 1 April 2008, for all unsupported borrowing, the MRP policy will be:
 - **Asset Life Method** – MRP will be based on the annuity method, which links MRP to the flow of benefits from an asset, starting in the year after the capital expenditure is incurred or, in the case of provision of a new asset, the MRP would begin in the financial year following the one in which the asset becomes operational.
- For non HRA capital expenditure from 1 April 2008, funded by borrowing, 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 the provision of a new asset, the financial year following the one in which the asset becomes operational.

<u>Expenditure type</u>	<u>Maximum period over which MRP to be made</u>
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 regulations, 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.

CIPFA is currently consulting on whether International Financial Reporting Standards in relation to PFI schemes should be introduced for 2009/10. If this is agreed, it is likely that most PFI assets would be on balance sheet. MRP is chargeable for any general fund assets that are on the balance sheet. There are proposals to mitigate this through the use of an MRP adjustment, to ensure there is no net effect on the amount charged to the Council tax.

10. Annual Investment Strategy

Investment Policy

The Council will have regard to Government Guidance on Local Government Investments (The Guidance), issued in March 2004, and CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (CIPFA TM Code).

Investment Principles

- As the general policy objective for the Council is the prudent investment of its treasury balances, its investment priorities are (a) the security of capital and (b) liquidity of its investments.
- As a general rule, temporary borrowing will not be undertaken whilst the City Council has temporary investments.
- The Council will aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.
- The Guidance points out that 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 last twelve months or so have been anything but. The Icelandic banks crisis, which did not impact on the City Council, along with the financial difficulties faced by UK and international banks, 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.
- Diversify the investment portfolio into more secure UK government and government backed investment instruments.
- Although 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, however. Greater security, and reduced exposure to risk, can only be achieved at the cost of lower rates of return.

Members are asked to note the revised Treasury Management investment strategy.

Specified and Non-Specified Investments

Investment instruments identified for use in the financial year are listed below under 'Specified' and 'Non-Specified' Investments categories.

Specified Investments

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

	Minimum 'High' Credit Criteria	Use
Term deposits – banks and building societies **	* Varied	In-house
Term deposits – other Local Authorities (LAs)	High security. Only one or two LAs credit rated	In-house ***
Debt Management Agency Deposit Facility	UK Government Backed	In-house - £100m limit
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 - Fitch : Long-Term A, Short-Term F1/F1+, Support 1,2,3; Moody's : Short-Term P-1.
Building Societies - Fitch : Long-Term A – or Moody's : Long-Term A3

** If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate.

*** Limit of £10m for District Councils, £20m for all other types of authority.

Non-Specified Investments

Non-specified investments are any other type of investment (i.e. not defined as specified above).

The only Non-specified investments the Council will make use of are term deposits with unrated building societies with assets in excess of £1 billion. A maximum limit of 20% of average total investments at any one time is in place for these non rated institutions, with an £8m individual limit for each institution and a maximum investment period of 90 days.

Investment Limits

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

Banks

AA+ £20 million

AA/AA- £15 million

A+/A £10 million

Building Societies

Fitch A- £10 million
(or Moodys long-term A3)

excluding Nationwide Building Society, whose AA- Fitch long-term rating warrants a higher (£15m) limit.

Liquidity

Based on cash flow forecasts, the level of cash balances in 2009-10 is estimated to range between £0m and £50m. The higher level can sometimes arise where, for instance, the City Council takes advantage of favourable long-term interest rates to borrow in advance of need.

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 in term deposit maturities in excess of 1 year.

In some instances, it is more cost effective to utilise cash resources to minimise the need for external borrowing and this option will be regularly considered by the City Treasurer.

Discussions are also ongoing with the Council's bankers (Co-op) with regard to an enhanced overdraft / short-term loan facility, to enable isolated substantial capital payments to be funded, pending longer term strategies being put in place.

Security of Capital: The use of Credit Ratings

Credit quality of counterparties (issuers and issues) and investment schemes will be determined by reference to credit ratings published by Moody's and Fitch rating agencies. The Council's minimum long-term, short-term and other credit rating criteria, which are considered sufficient for each category of investment, will be adhered to at all times.

Monitoring of credit ratings:

- A All credit ratings will be monitored on a continual basis and reviewed monthly. The Council is alerted by Sector, its external Treasury Management advisors, to changes in Moody's and Fitch ratings.
- B 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.
- C If a counterparty/investment scheme is upgraded so that it fulfils the Council's criteria, the City Treasurer will have the discretion to include it on the lending list.

In past years, the use of credit ratings was deemed sufficient to ensure the security of investments for all institutions. This is not the case now, and a number of other important issues also need to be taken into consideration:-

- 1 Since the credit crunch crisis, a number of banks have been nationalised. An assessment of their suitability for investing with, based purely on their credit ratings, would show that they no longer meet our minimum credit rating criteria and should be removed from our lending list. Nationalisation of these banks, however, means they effectively take on the creditworthiness of the UK Government itself, i.e., deposits made with them are effectively being made to the UK Government. The financial limits of these banks have also been increased to reflect the higher levels of security.
- 2 The Northern Rock crisis and the Icelandic banks fiasco have shown deficiencies in relying exclusively on credit ratings, which are reactive and only respond after the event. In order to protect the security of the Council's investments, a further check has been introduced. Where market intelligence gives an early indication that a bank or building society could soon start to experience financial difficulties, that institution is removed from our lending list for a period of 3 months, subject to review thereafter.
- 3 Even though the UK Government has underlined its determination to ensure the security of the UK banking system by supporting eight named banks with a £500bn support package, it has not given a blanket guarantee on all deposits. The investment instruments included in the Specified Investments table above referred to as "covered by UK Government guarantee" are included only because they have an explicit Government guarantee.
- 4 Credit Default Swap (CDS) spreads are scores, which are allocated to banks, which can be translated into the likelihood of that institution defaulting on their loan repayment obligations. The higher the score, the

greater the likelihood of default. Sector currently have in place procedures where CDS spreads can be provided, using information sourced from the financial markets, for individual establishments. They are looking to develop this system still further, to include all establishments on their credit rating list. The feasibility of accessing and using this CDS spreads data system will be explored.

Investment Strategy to be followed in-house

Bank Rate started on a downward trend, from 5.75%, in December 2007, with further cuts of 0.25% in February and April 2008, then 0.5% in October, 1.5% in November, 1% in December and 0.5% in January, to reach its current level of 1.5%. Further cuts of 1.5% are expected during the first quarter of 2009. Bank Rate is then expected to stabilise at 0.50% until starting to rise gradually, with the first increase in quarter 2 of 2010 and, then, to be back up to 4.00% during the first quarter of 2012. The Council will seek to utilise its 'business reserve accounts' with major banks and short-dated deposits (overnight to 3 months) in order to benefit from the compounding of interest.

End of year Investment Report

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

11. Recommendations

To note the proposed Treasury Management Strategy Statement and approve:-

- The Prudential Indicators referred to in section 3 and listed in Appendix 4 to Annex 1 of this report.
- The Borrowing Requirements listed in section 5.
- The Borrowing Strategy outlined in section 8.
- The MRP Strategy outlined in section 9.
- The Annual Investment Strategy detailed in section 10.

Appendix A

INTEREST RATE FORECASTS

The data below shows a variety of forecasts published by a number of institutions, including those of UBS and Capital Economics (an independent forecasting consultancy). The forecast within this strategy statement has been drawn from these diverse sources and officers' own views.

Sector View interest rate forecast – 6 December 2008

	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009	Q/E1 2010	Q/E2 2010	Q/E3 2010	Q/E4 2010	Q/E1 2011	Q/E2 2011	Q/E3 2011	Q/E4 2011	Q/E1 2012
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.75%	2.50%	3.25%	3.75%	4.00%
5yr PWLB rate	2.50%	2.25%	2.15%	2.15%	2.15%	2.45%	2.80%	3.15%	3.65%	3.95%	4.20%	4.45%	4.60%
10yr PWLB rate	3.10%	2.75%	2.55%	2.55%	2.55%	2.85%	3.25%	3.65%	4.15%	4.40%	4.70%	4.75%	4.85%
25yr PWLB rate	4.00%	3.95%	3.95%	3.95%	4.00%	4.15%	4.35%	4.45%	4.60%	4.85%	4.95%	5.00%	5.05%
50yr PWLB rate	3.85%	3.80%	3.80%	3.80%	3.85%	3.90%	4.00%	4.25%	4.40%	4.70%	4.80%	4.95%	5.00%

Capital Economics interest rate forecast – 12 January 2009

	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009	Q/E1 2010	Q/E2 2010	Q/E3 2010	Q/E4 2010	Q/E1 2011
Bank Rate	0.50%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
5yr PWLB rate	1.65%	1.45%	1.45%	1.45%	1.45%	1.45%	1.45%	1.45%	0.15%
10yr PWLB rate	2.65%	2.15%	2.15%	2.15%	2.15%	2.15%	2.15%	2.15%	0.15%
25yr PWLB rate	4.15%	4.00%	3.80%	3.65%	3.65%	3.65%	3.65%	3.65%	0.15%
50yr PWLB rate	4.05%	3.95%	3.85%	3.75%	3.75%	3.75%	3.75%	3.75%	0.25%

UBS Economic interest rate forecast (for quarter ends) – 12 December 2008

	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009
Bank rate	0.50%	0.50%	0.50%	0.75%
10yr PWLB rate	3.75%	4.15%	4.35%	4.65%
25yr PWLB rate	4.25%	4.55%	4.85%	5.05%
50yr PWLB rate	4.30%	4.65%	5.00%	5.25%

Appendix B

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.