Treasury Management Strategy Statement, Annual Investment Strategy and Minimum Revenue Provision Policy Statement 2011/12

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). 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 1 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 15th February 2010.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council’s treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. 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 (stewardship report) covering activities during the previous year.
4. 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.
5. 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 Executive & Resources PDS 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 adviser, Sector.

The strategy covers:

- treasury limits in force which will limit the treasury risk and activities of the Council
- Prudential and Treasury Indicators
- the current treasury position
- the borrowing requirement
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy
- creditworthiness policy
- policy on use of external service providers
- the MRP strategy

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 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

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 and Wales the Authorised Limit represents the legislative limit specified in the Act.

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'.

Whilst termed an "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 within the Prudential Indicators (Annex 3 of this Strategy – page 22).

3. Current Treasury Position

The Council's investment position at 31st December 2010 comprised:

Investments	**Total principal maturing**
Fixed term deposits	£m
Maturities due in 2010/11	40.0
Maturities due in 2011/12	100.0
Maturities due in 2012/13	20.0
Other Investments	
Money Market Funds	14.2
35-day notice account	15.0
"Frozen" investment with Heritable	5.0
Total Investments as at 31/12/10	**194.2**

With regard to the current borrowing position, the Council currently has no external debt other than around £10m which is shown as other long-term liabilities on our Balance Sheet.

4. Prudential and Treasury Indicators for 2011/12 – 2013/14

Prudential and Treasury Indicators (as set out in Annex 3 – page 22 of this report) are relevant for the purposes of setting an integrated treasury management strategy.

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 in February 2002 and the revised 2009 Code was adopted by the full council on 15th February 2010.

5.Prospects for Interest Rates

The Council has appointed Sector as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates. Annex 2 (pages 20-21) shows Sector's view on the interest rate outlook and draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Sector central view.

Sector Bank Rate forecast for financial year ends (March)

- 2010/ 2011 0.50%
- 2011/ 2012 1.00%
- 2012/ 2013 2.25%
- 2013/ 2014 3.25%

Annual Average %	Bank Rate	Money Rates		PWLB Rates*			
		3 month	1 year	5 year	10 year	25 year	50 year
2010/11	0.5	0.7	1.5	2.6	3.7	4.6	4.7
2011/12	0.7	1.0	1.8	3.3	4.3	5.3	5.4
2012/13	1.7	2.0	2.8	4.2	4.8	5.5	5.6
2013/14	3.1	3.2	3.7	4.8	5.3	5.6	5.7
2014/15	4.0	4.2	4.5	5.6	5.6	5.6	5.8
2015/16	4.0	4.2	4.2	5.3	5.4	5.5	5.5

* Borrowing Rates

There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected. A detailed view of the current economic background is contained within Annex 4 (23-24) to this report.

6. Borrowing Strategy

The Council currently does not borrow to finance capital expenditure and finances all expenditure from external contributions, capital receipts or internal balances. Internal borrowing has been agreed, however, to finance a number of capital schemes, including SEN provision and other school capital works. A total of £3.5m of capital expenditure was left unfinanced at the end of 2009/10 in respect of the reprovision of special schools and this is expected to rise to around £4.6m by the end of 2010/11. This has resulted in the Council having a positive Capital Financing Requirement, effectively creating a need to borrow. In accordance with external advice, this is being treated as an internal advance, with repayments being met from the schools' budget with no impact on the Council's General Fund.

The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy. Long-term fixed interest rates are at risk of being higher over the medium term. If a further need to borrow arises, the Director of Resources, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above. It is likely that shorter term fixed rates may provide better opportunities.

The option of postponing borrowing and running down investment balances will also be considered. This would reduce counterparty risk and hedge against the expected fall in investments returns.

7. Annual Investment Strategy

7.1 Investment Policy

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.

Investment instruments identified for use in the financial year are listed in Annex 5 (pages 25-27) under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

7.2 Creditworthiness policy

This 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 and 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. The Council would not be able to replicate this level of detail using in-house resources. The colour code bands indicate Sector's recommendations on the maximum duration for investments. The Council uses this information, together with its own view on the acceptable level of counterparty risk, to form its creditworthiness policy.

The Director of Resources will maintain a counterparty list in compliance with the agreed criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to those that choose Specified and Non-Specified investments as they select which counterparties the Council will choose rather than defining what its investments are. In line with CIPFA's recommendation, the rating criteria will use the **lowest common denominator** method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one of which meets the Council's criteria while the other does not, the institution will fall outside the lending criteria. The Council will also apply a minimum sovereign rating of AA+ to investment counterparties. The Council's detailed eligibility criteria for investments with counterparties are included in Annex 5 (pages 25-27).

All credit ratings will be continuously monitored. 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 movements in Credit Default Swap against the iTraxx benchmark and other market data on

a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Further advice is also received from the Council's external cash manager, Tradition UK.

Sole reliance will not be placed on these external advisers. 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. The Council forms a view and determines its investment policy and actions after taking all these factors into account.

7.3 Country limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA+ from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). The list of countries that qualify using these credit criteria as at the date of this report is shown in Annex 6 (page 28). This list will be amended by officers should ratings change in accordance with this policy.

7.4 Investment Strategy

In-house funds: The Council's core portfolio is around £150m and cashflow variations during the course of the year have the effect from time to time of increasing the total investment portfolio to a maximum of around £200m. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Interest rate outlook: Bank Rate has been unchanged at 0.50% since March 2009 and is forecast to commence rising in quarter 4 of 2011 and then to rise steadily from thereon. Bank Rate forecasts for financial year ends (March) are as follows:

- 2010/ 2011 0.50%
- 2011/ 2012 1.00%
- 2012/ 2013 2.25%
- 2013/ 2014 3.25%

There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected.

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. In 2009/10, the Council was constrained by a maximum investment period of 1 year (3 months for lower rated institutions). However, following advice from Sector and Tradition UK that would permit up to 2 years with the strongest all-round banks, this was relaxed and the 2010/11 Strategy permitted investment for up to 2 years with the Lloyds TSB and RBoS groups.

Sector's suggested budget for investment returns on investments placed for up to three months during each financial year is shown below, together with the assumptions made by the Council in the financial forecast, which are based on a longer average duration.

	Sector 3-month View	Council View
2010/11	0.50%	1.50%
2011/12	1.00%	1.75%
2012/13	2.00%	2.50%
2013/14	3.20%	3.50%

2014/15	4.20%	4.25%
2015/16	4.20%	4.25%

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

7.5 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.

7.6 External fund managers

£20m of the Council's funds are externally managed on a discretionary basis by Tradition UK. They are required to comply with the Annual Investment Strategy and are permitted to use specified and non-specified investments, subject to the Council's own limits. The managers' performance is closely monitored by the Director of Resources and reported quarterly to the Resources Portfolio Holder and the Executive & Resources PDS Committee.

7.7 Policy on the use of external service providers

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 external service providers.

However, the Council recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources and it uses Sector for this purpose. 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.

7.8 Scheme of delegation

See Annex 7 (page 29).

7.9 Role of the section 151 officer

See Annex 8 (page 30).

ANNEXES

1. MRP strategy
2. Interest rate forecasts
3. Prudential and Treasury indicators
4. Economic background
5. Specified and non specified investments
6. Approved countries for investments
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8. The treasury management role of the section 151 officer

ANNEX 1. Minimum Revenue Provision Policy Statement 2011/12

The Council is required by Regulation under the Local Government and Public Involvement in Health Act 2007 to approve an annual MRP Policy, which sets out how the Council will pay for capital assets through revenue each year. The Council is required to pay off an element of the accumulated General Fund capital spend each year through a revenue charge (the MRP), although it is also allowed to undertake additional voluntary payments (VRP). The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2009/10 and assesses its MRP 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.

MRP will be based on the estimated lives of the assets, in accordance with the proposed regulations and will follow standard depreciation accounting procedures. Estimated life periods will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

In practice, the Council's MRP is assessed as 4% of the outstanding balance on the internal borrowing that has been approved in respect of special education schemes.

ANNEX 2. Interest rate forecasts

The Outlook for Interest Rates (Sector View – January 2011)

The key theme of uncertainty continues with mixed economic data. Whilst short-term rates are expected to remain on hold through most of 2011, inflationary concerns are increasing. Inflation has been above the 2% target for so long the credibility of the MPC may become a greater focus. This will make the MPC's decisions during 2011 a difficult judgment; control inflation or continue to aid the recovery? The MPC will be particularly concerned that the public's inflation expectations could become unhinged. We have not changed our Bank Rate forecast; however, there is a risk that the MPC may feel they will need to take action earlier than Q4, i.e. Q3, in order to reinforce its credibility.

The recovery in the economy is well underway; however, the strong rates of growth we have seen are unlikely to be sustained. The Government's determination to cut the size of the public sector deficit will be a drag upon activity in the medium term. The void left by significant cuts in public spending will need to be filled by a number of alternatives – corporate investment, rising exports (assisted by the fall in the value of sterling) and consumers' expenditure. In terms of sheer magnitude, the latter is the most important and strong growth in this area is by no means certain. The combination of the desire to reduce the level of personal debt, lack of access to credit and continued job uncertainty is likely to weigh heavily upon spending. This will be amplified by fiscal policy tightening, in the Comprehensive Spending Review. Without growth in personal spending remaining robust, any recovery in the economy is set to be weak and protracted.

Fiscal support in the US through the extension of tax cuts and monetary support through the extension of quantitive easing (QEII, with the potential for further easing), has had an adverse effect on world bond markets. Following the recent sell off the outlook for long-term interest rates is favourable in the near term, but is set to deteriorate again in the latter part of 2011. The increase in yields will be suppressed by continued investor demand for safe haven instruments following the uncertainties and unfolding tensions within the entire Eurozone. In addition to this, the market has been underpinned by evidence of moderating activity in major economies and the coalition government's determination to deal with the parlous state of public sector finances. These two factors will restrict any deterioration in gilt market performance in the near term.

However, while the UK's fiscal burden will almost certainly ease, it will be a lengthy process and deficits over the next two to three financial years will still require a very heavy programme of gilt issuance. The latest Bank Inflation Report suggests the market will not be able to rely upon Quantitative Easing indefinitely to alleviate this enormous burden.

Eventually, the absence of the Bank of England as a continued buyer of gilts will shift the balance between supply and demand in the gilt-edged market. Other investors will almost certainly require some incentive to continue buying government paper.

This incentive will take the form of higher yields. The longer end of the curve will suffer from the lack of support from the major savings institutions – pension funds and insurance companies - who will continue to favour other investment instruments as a source of value and performance.

Although the FSA has recently delayed implementation of their liquidity requirements, the regulator will still look to ensure banks have necessary short term liquidity. The front end of the curve will benefit from this and will ensure the steeply-positive incline of the yield curve remains intact.

Interest Rate Forecasts

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 summarised 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 – January 2011

Year	End Period	Bank Rate	Money Rates 3mth	6mth	12mth	PWLB Rates* 5 yr	10 yr	25 yr	50 yr
2010	Sep	0.50	0.7	1.0	1.5	1.9	3.1	4.0	4.0
	Dec	0.50	0.7	1.0	1.5	3.3	4.6	5.2	5.2
	4 Jan	0.50	0.6	0.9	1.4	3.4	4.6	5.3	5.2
2011	Mar	0.50	0.6	0.9	1.4	3.3	4.4	5.2	5.2
	Jun	0.50	0.7	1.0	1.5	3.3	4.4	5.2	5.2
	Sep	0.50	0.8	1.1	1.6	3.4	4.4	5.2	5.2
	Dec	0.75	1.0	1.2	1.8	3.5	4.5	5.3	5.3
2012	Mar	1.00	1.3	1.5	2.1	3.6	4.7	5.3	5.3
	Jun	1.25	1.5	1.8	2.4	3.8	4.8	5.4	5.4
	Sep	1.50	1.8	2.1	2.7	3.9	4.9	5.4	5.4

Capital Economics

Interest rate forecast – December 2010

	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
5yr PWLB rate	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%
10yr PWLB rate	3.75%	3.75%	3.75%	3.75%	3.75%	3.75%	3.75%
25yr PWLB rate	4.80%	4.80%	4.80%	4.80%	4.80%	4.80%	4.80%
50yr PWLB rate	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%

UBS

Interest rate forecast (for quarter ends) – December 2010

	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
Bank rate	0.50%	0.50%	0.50%	0.75%	1.00%
10yr PWLB rate	4.00%	4.10%	4.30%	4.50%	4.60%
25yr PWLB rate	5.10%	5.10%	5.10%	5.20%	5.30%
50yr PWLB rate	5.10%	5.20%	5.20%	5.30%	5.40%

2. Survey of Economic Forecasts

HM Treasury October 2010

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

BANK RATE FORECASTS	Bank Rate	Quarter end		Annual ave. Bank Rate				
	actual	Q4 2010	Q4 2011	ave. 2010	ave. 2011	ave. 2012	ave. 2013	ave. 2014
Median	0.50%	0.50%	0.90%	0.50%	1.00%	1.90%	2.80%	3.40%
Highest	0.50%	0.80%	3.20%	0.60%	2.10%	3.10%	4.10%	5.30%
Lowest	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	1.20%

ANNEX 3. Prudential and Treasury Indicators

Prudential and Treasury Indicators are relevant for the purposes of setting an integrated treasury management strategy.

The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This original 2001 Code was adopted by the full Council in February 2002 and the revised version of the Code (2009) was adopted by full Council in February 2010.

PRUDENTIAL INDICATORS	2009/10	2010/11	2011/12	2012/13	2013/14
	actual	probable	estimate	estimate	estimate
	£m	£m	£m	£m	£m
Total Capital Expenditure	£42.5m	£75.4m	£48.0m	£20.7m	£14.5m
Ratio of financing costs (net interest income for Bromley) to net revenue stream	-2.2%	-1.4%	-1.3%	-1.5%	-2.0%
Net borrowing requirement (net investments for Bromley)					
brought forward 1 April	£122.1m	£133.9m	£134.5m	£124.3m	£126.7m
carried forward 31 March	£133.9m	£134.5m	£124.3m	£126.7m	£124.4m
in year movement (+ increase;- reduction in net investments for Bromley)	+10.8m	+£0.6m	-£10.2m	+£2.4m	-£2.3m
Capital Financing Requirement as at 31 March (unfinanced exp re SEN provision)	£3.5m	£4.6m	£4.4m	£4.2m	£4.0m
Annual change in Capital Financing Requirement	-£0.2m	+£1.3m	-£0.2m	-£0.2m	-£0.2m
Incremental impact of capital investment decisions	£ p	£ p	£ p	£ p	£ p
Increase in council tax (band D) per annum	-	-	-	-	-

TREASURY MANAGEMENT INDICATORS	2009/10	2010/11	2011/12	2012/13	2013/14
	actual	probable	estimate	estimate	estimate
	£m	£m	£m	£m	£m
Authorised Limit for external debt -					
borrowing	£30.0	£30.0	£30.0	£30.0	£30.0
other long term liabilities	£30.0	£30.0	£30.0	£30.0	£30.0
TOTAL	£60.0	£60.0	£60.0	£60.0	£60.0
Operational Boundary for external debt -					
borrowing	£10.0	£10.0	£10.0	£10.0	£10.0
other long term liabilities	£20.0	£20.0	£20.0	£20.0	£20.0
TOTAL	£30.0	£30.0	£30.0	£30.0	£30.0
Actual external debt	£10.2	£10.0	£10.0	£10.0	£10.0
Upper limit for fixed interest rate exposure	100%	100%	100%	100%	100%
Upper limit for variable rate exposure	20%	20%	20%	20%	20%
Upper limit for total principal sums invested beyond year-end dates	£144.1	£144.5	£134.3	£136.7	£134.4

ANNEX 4. Economic Background

4.1. 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, is currently in progress as at November 2011.

The unexpectedly high rate of growth in quarters 2 and 3 of 2010 in the UK and the Euro zone in Q2 was 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 the western world in 2011.

4.2 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 will 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 next year.

Economic Growth – GDP growth is likely to have peaked in the current period of recovery at 1.2% in quarter 2 of 2010. The first estimate of +0.8% for quarter 3 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 turned around since July 2010 with small increases being seen, which are likely to be the start of a new trend of rising unemployment for some years ahead.

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%). 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 after another rise back up to about 3.5% by the end of 2010.

The Bank of England finished its programme of quantitative easing (QE) in November 2009, when the total stood at £200bn. Major expectations that there could be a second round of quantitative easing in late 2010 or early 2011, to help support economic growth, have evaporated after the surprises of the Q3 GDP figure of +0.8% 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.

4.3 Sector's forward view

It is currently difficult to have confidence as to exactly how strong the UK economic recovery is likely to be, 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 for more quantitative easing, and the timing of this in both the UK and US, and its subsequent reversal
- 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

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.

ANNEX 5. Specified and Non-Specified Investments

Eligibility Criteria for investment counterparties

SPECIFIED INVESTMENTS

These investments are sterling investments of not more than one-year maturity or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are low risk investments where the possibility of loss of principal or investment income is small. These would include investments with:

1. The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
2. A local authority, parish council or community council.
3. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency.
4. A bank or building society that has been awarded a high credit rating by a credit rating agency.
5. A bank or building society that is an eligible institution under the HM Treasury Credit Guarantee Scheme and that has been has been awarded a minimum long and short-term credit rating by a credit rating agency.

Minimum credit ratings (as rated by Fitch, Moody's and Standard & Poors) and monetary and time period limits for all of the above categories are set out below. The rating criteria use the **lowest common denominator** method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one of which meets the Council's criteria while the other does not, the institution will fall outside the lending criteria. The Council will take into account other factors in determining whether an investment should be placed with a particular counterparty, but all investment decisions will be based initially on these credit ratings criteria. The Council will also apply a minimum sovereign rating of AA+ to investment counterparties.

NON-SPECIFIED INVESTMENTS

Non-specified investments are any other type of investment (i.e. not defined as Specified above) and can be for any period over 1 year. The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below.

	Non Specified Investment Category	**Limit (£ or %)**
a.	***Bank Deposits*** (with a maturity of more than one year) These can be placed in accordance with the limits of the Council's counterparty list criteria (i.e. subject to satisfaction of Fitch, Moody's and Standard & Poors credit ratings criteria shown above).	£40m group limit with Lloyds TSB and RBS, subject to eligibility criteria below.
b.	***Building Society Deposits*** (with a maturity of more than one year) These can be placed in accordance with the limits of the Council's counterparty list criteria (i.e. subject to satisfaction of Fitch, Moody's and Standard & Poors credit ratings criteria shown above.	None permitted at present.
c.	**Gilt edged securities** with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. The use of UK Government gilts is restricted to fixed date, fixed rate stock with a maximum maturity of five years. The total investment in gilts is limited to £25m and will normally be held to maturity, but the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before	£25m.

	maturity. The Director of Resources must personally approve gilt investments. The Council currently has no exposure to gilt investments.	
d.	***Non-rated subsidiary*** of a credit-rated institution that satisfies the Council's counterparty list criteria. Investments with non-rated subsidiaries are permitted, but the credit-rated parent company and its subsidiaries will be set an overall group limit for the total of funds to be invested at any time.	None permitted at present.

CRITERIA FOR FUNDS MANAGED INTERNALLY AND EXTERNALLY

- **UK Banks 1 –** the Council will place investments up to a total of £40m for up to 2 years with the part-nationalised UK banks Lloyds TSB and the Royal Bank of Scotland provided their short and long-term ratings remain at least F1+/A+ (Fitch), P-1/A1 (Moodys) and A-1/A+ (S&P).

- **UK Banks 2** – the Council will place investments up to a total of £30m for up to 1 year with UK banks that have at least the following Fitch, Moody's and Standard & Poors ratings (where rated).

	Short-Term	Long-Term	Indiv/Fin Str	Support
Fitch	F1+	AA-	C	3
Moodys	P-1	Aa3	C	
S & P	A-1+	AA-		

- **Eligible Institutions under the HM Treasury Credit Guarantee Scheme 1** – the Council will place investments up to a total of £20m for up to 1 year with UK banks and building societies (with the exception of Lloyds TSB and RBoS - see above) that are Eligible Institutions and that have at least the following Fitch, Moody's and Standard & Poors ratings (where rated). This category will also include eligible institutions that have been placed on negative watch/outlook by the ratings agencies, but which would otherwise meet the minimum credit ratings criteria in UK Banks 2 above.

	Short-Term	Long-Term
Fitch	F1+	A+
Moodys	P-1	A1
S & P	A-1	A+

- **Eligible Institutions under the HM Treasury Credit Guarantee Scheme 2** – the Council will place investments up to a total of £10m for up to 3 months with UK banks and building societies that are Eligible Institutions and that have at least the following Fitch, Moody's and Standard & Poors ratings (where rated):

	Short-Term	Long-Term
Fitch	F1	A-
Moodys	P-1	A3
S & P	A-1	A-

- **Other banks and building societies 1** - the Council will place investments up to a total of £15m for up to 1 year with UK and overseas banks and building societies that are not

Eligible Institutions and that have at least the following Fitch, Moody's and Standard & Poors ratings (where rated):

	Short-Term	Long-Term	Indiv/Fin Str	Support
Fitch	F1+	AA-	C	3
Moodys	P-1	Aa3	C	
S & P	A-1+	AA-		

- **Other banks and building societies 2** - the Council will place investments up to a total of £5m for up to 3 months with UK and overseas banks and building societies that are not Eligible Institutions and that have at least the following Fitch, Moody's and Standard & Poors ratings (where rated):

	Short-Term	Long-Term	Indiv/Fin Str	Support
Fitch	F1	A-	C	3
Moodys	P-1	A3	C	
S & P	A-1	A-		

- **Sovereign Ratings** – only counterparties in countries with sovereign ratings of AAA and AA+ may be used.
- **Bank Subsidiary and Treasury Operations** – the Council will use these where the parent bank has the necessary ratings outlined above. The total investment limit and period will be determined by the parent company credit ratings.
- **Money Market Funds** – The Council is authorised to invest in AAA rated Money Market Funds. The total invested in each of these Funds must not exceed £15m at any time.
- **UK Government (including gilts and the DMADF)** – the Council may invest in the government's DMO facility for a maximum of 1 year, but with no limit on total investment. The use of UK Government gilts is restricted to a total of £25m and to fixed date, fixed rate stock with a maximum maturity of 1 year. The Director of Resources must personally approve gilt investments.
- **Local Authorities, Parish Councils etc** - Investment is permitted with any local authority, subject to a maximum exposure of £15m with any local authority at any time.
- **Business Reserve Accounts** - business reserve accounts may be used from time to time, but value and time limits will apply to counterparties as detailed above.

ANNEX 6. Approved countries for investments

The Council may only place investments with counterparties in countries with sovereign ratings of AAA and AA+. Eligible countries are currently as follows:

AAA

- Canada
- Denmark
- Finland
- France
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland
- U.K.
- U.S.A.

AA+

- Australia
- Belgium
- Spain

ANNEX 7. Treasury management scheme of delegation

(i) Full board/council

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

(ii) Boards/committees/council/responsible body

- 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/person(s) with responsibility for scrutiny

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

ANNEX 8. 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.