**Annex D**

# Northampton Borough Council
# Treasury Management Strategy 2010-11

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## Introduction and Equalities Statement

### *Introduction*

The Council is required to adopt the CIPFA Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes (Fully revised second edition 2009) and it is a requirement under that Code of Practice to produce an annual strategy report on proposed treasury management activities for the year.

The Treasury Management Strategy Report incorporates:

(i) The Capital Financing and Borrowing Strategy for the coming year including:

- The Council's policy on the making of Minimum Revenue Provision (MRP) for the repayment of debt, as required by the Local Authorities (Capital Finance & Accounting) (Amendments) (England) Regulations 2008.
- The Affordable Borrowing Limit as required by the Local Government Act 2003.

(ii) The Investments Strategy for the coming year as required by the CLG (formerly ODPM) Guidance on Local Government Investments issued in 2004.

The purpose of the Treasury Strategy is to establish the framework for the effective and efficient management of the Council's treasury management activity, including the Council's investment portfolio, within legislative, regulatory, and best practice regimes, and balancing risk against reward in the best interests of stewardship of the public purse.

### *Key Principles*

The key principles of the CIPFA Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes are that:

- Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.

- Their policies and practices should make clear that the effective management and control of risk are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy and should ensure that priority is given to security and liquidity when investing funds.

- They should acknowledge that the pursuit of value for money in treasury management, and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this.

The Treasury Strategy that follows, and the Council's Schedules to the Treasury Management Practices at report Annex C, are drafted in the context of these principles, as well as the requirements of the four key clauses (report Annex A), the treasury management policy statement (report Annex B), and the Treasury Management Practices (report Annex C).

***Equalities Statement***

An Equalities Impact Assessment has been carried out on the Council's Treasury Strategy for 2010-11, and the associated Treasury Management Practices (TMPs) and the Schedules to the TMPs.

As a result of that assessment, it should be noted that the potential impact of the strategy and associated documents (including Treasury Management Practices (TMPS) and the Schedules to the TMPs) on the different equalities groups must be considered as it is developed and put together each year. This includes the consideration of the potential impact on the different equalities groups of any processes, procedures or outcomes arising from these.

# Capital Financing and Borrowing Strategy

## 1. Capital Financing

The Council's capital programme is financed by borrowing and by other available sources such as capital receipts, grants, third party contributions and revenue contributions.

The Council makes use of operating leases to fund some types of expenditure that would otherwise be treated as capital where they offer better value for money. Examples of the types of expenditure that might be suitable are IT equipment and office furniture. The annual costs of operating leases are currently treated as revenue expenditure in the accounts and are not included in the Council's capital programme.

The Council's policy is not to enter into finance leases, which have to be treated as capital expenditure in the accounts, and generally do not offer any financial benefits to the authority.

However the treatment of leases is set to change with the introduction from 2010-11 of International Financial Reporting Standards (IFRS). Some leases currently defined as operating leases will be treated as finance leases, and this will include some retrospective adjustments.

There are two scenarios where borrowing may be used to fund the Council's capital expenditure.

(i) Supported borrowing – The government may award borrowing approvals in the form of Supported Capital Expenditure (Revenue) (SCE(R)) and provide associated revenue support to meet some of the costs of borrowing (i.e. repayment of principal and interest). This is targeted towards specific service blocks, including education and social services. The nature of district council services means that very little supported borrowing is awarded to this Council, with the exception of a limited amount for housing services.

(ii) Prudential borrowing – The Council has to fund the full costs of borrowing from its own revenue resources. This is sometimes referred to as unsupported borrowing. This method of funding is particularly suitable for 'spend to save' schemes, where the financing costs of borrowing can be funded from revenue savings. However lack of capital resources means that it is also used for other essential capital schemes where no other resources can be identified.

## 2. Existing Borrowing

Existing borrowing to fund capital expenditure stands at £31.8m. This borrowing is primarily in the form of Money Market LOBO (Lenders Option, Borrowers Option) loans. However borrowing from the Public Works Loans Board (PWLB) is now also included in the Council's debt portfolio. The following tables illustrate the debt type and maturity profile of existing borrowing as at 31 January 2010.

**Analysis of Outstanding Debt as at 31 January 2010**

| Type of Loan | Principal £'000 | Proportion of Long Term Debt % | Range of Interest | |
|---|---|---|---|---|
| | | | From % | To % |
| Public Works Loan Board | 6,000 | 19 | 3.47 | 3.97 |
| Money Market LOBO Loans | 24,600 | 77 | 4.85 | 7.03 |
| Homes and Communities Agency | 1,242 | 4 | 9.25 | 9.25 |
| | | | | |
| **Total** | 31,842 | 100 | | |

**Long Term Debt Maturity Profile as at 31 January 2010**

| Time Frame: within - | Year | Value Maturing £'000 | Proportion of Long Term Debt % |
|---|---|---|---|
| 0-10 years | 2009/10-2018/19 | 21,806 | 68 |
| 10-20 years | 2019/20-2028/29 | 532 | 2 |
| 20-30 years | 2029/30-2038/39 | 504 | 2 |
| 30-40 years | 2039/40-2048/49 | 0 | 0 |
| Over 40 years | 2049/50 onward | 9,000 | 28 |
| | | | |
| **Total** | | 31,842 | 100 |

## 3. New Borrowing

The Council has access to Public Works Loan Board (PWLB) loans for its long term borrowing needs. Loans, including LOBO loans, are also available from major banks via the Money Market and these may be considered when they offer better value for money than PWLB loans.

Decisions on the timing and type of borrowing are taken in consultation with the Council's external treasury management advisors.

Under the Local Government Act 2003 local authorities are able to borrow in year for the current year capital programme and for the following two years.

The Council's policy on borrowing in advance of need is that this will not be undertaken 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.

The Council will:

- Ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio 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.

£6m of borrowing was undertaken in January 2010 with the Public Works Loans Board (PWLB) to provide for capital programme expenditure in 2010-11 and 2011-12. Interest rates on borrowing are forecast to rise over the coming three-year period, and this strategy will lock the Council into borrowing costs, as far as possible, at the lowest level forecast.

It is anticipated that no further external borrowing will be required to fund the 2010-11 and 2011-12 capital programmes. However, borrowing of around £8m has been budgeted for 2012-13 to support the HRA programme, which is directed at meeting decent homes targets.

## 4. Minimum Revenue Provision (MRP)

Prior to 2007-08 the Council was required by statute to provide for the repayment of a minimum amount of 4% of General Fund debt principal each year. This debt repayment is known as the Minimum Revenue Provision (MRP). The Housing Revenue Account is not subject to an MRP charge.

The Local Authorities (Capital Finance & Accounting) (Amendments) (England) Regulations 2008, which came into force in February 2008, required local authorities to make instead 'prudent provision' for the repayment of debt. A number of options for prudent provision are set out in the regulations. The underlying principle is that the repayment of debt should be more closely aligned to the useful life of the asset or assets for which the borrowing has been carried out.

In 2007-08 the Council used the transitional measures available to calculate MRP for all capital expenditure prior to 1 April 2008 as if the previous regulations were still in force.

The authority is required, under the 2008 regulations, to prepare an annual statement of their policy on making MRP for submission to Council. The Council's policy statement on MRP for 2010-11 (which also applied to 2008-09 and 2009-10) is set out in the following paragraphs:

*The Council will implement the new Minimum Revenue Provision (MRP) guidance in 2008-09 and future years, and assess their MRP for 2008-09 and future years 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 relating to the historic debt liability incurred for years up to and including 2007-08 will continue to be charged at the rate of 4% on the reducing balance, in accordance with option 1 of the guidance, the "regulatory method".*

*The debt liability relating to capital expenditure incurred in 2008-09 and future years will be subject to MRP under option 3, the "asset life method", and will be charged over a period that is reasonably commensurate with the estimated useful life applicable to the nature of expenditure, using the equal annual instalment method. For example, capital expenditure on a new building, or on the refurbishment or enhancement of a building, will be related to the estimated life of that building.*

*Estimated life periods will be determined in line with accounting guidance and regulations. 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, the Council will generally adopt these periods. 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.*

*As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis that most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner that reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.*

*Where finance leases are held on the balance sheet, the MRP will be set at a charge equivalent to the element of the annual lease charge that goes to write down the balance sheet liability, thereby applying Option 3 in a modified form.*

*The Council will take advantage of any transitional arrangements introduced to minimise or negate the impact of retrospective accounting adjustments as a result of the transfer to the balance sheet of finance leases previously treated as operating leases under the introduction of IFRS.*

Applying the policy as set out above, MRP for the next three years is estimated at:

| | 2010-11<br>£000 | 2011-12<br>£000 | 2012-13<br>£000 |
|---|---|---|---|
| Repayment of debt principal (MRP) | 722 | 902 | 959 |

## 5. Borrowing Requirement

The Council's long-term borrowing requirement for the next three years is estimated at:

| | | **2010-11**<br>**£m** | **2011-12**<br>**£m** | **2012-13**<br>**£m** |
|---|---|---|---|---|
| (i) | New borrowing to cover new capital expenditure | 6.125 | 5,853 | 10.168 |
| (ii) | Replacement of loans maturing in year | 0.00 | 0.00 | 0.00 |
| (iii) | Less: debt repayment (see Section 4) | (0.722) | (0.902) | (0.959) |
| | **Total new borrowing/ (provision for debt repayment)** | **5.403** | **4.951** | **9.209** |

See Section 3 above for the Council's strategy on new borrowing for capital expenditure in 2010-11 to 2012-13.

## 6. Debt Rescheduling

As is the current practice, the debt portfolio will be kept under review throughout 2010-11 and beyond; with debt rescheduling opportunities being investigated for potential cash savings and / or discounted cash flow savings or to enhance the balance of the portfolio.

Recent changes to accounting regulations, and to the structure of PWLB rates, mean that rescheduling opportunities are more limited than in the past, but decisions will be based on appropriate advice from the Council's external treasury management advisers.

LOBO loans of £15.6m, 50% of the current debt portfolio, are due for repayment in 2014-15. Officers are investigating options to manage this, and will consult with the Council's treasury advisers to determine whether it is prudent to let these loans run their full course or to repay or reschedule them.

Any debt rescheduling will be reported to Cabinet at the meeting following its action.

## 7. Long Term Interest Rates for Borrowing

Interest rates on PWLB and Money Market loans fluctuate daily according to market conditions, and in accordance with movements on the gilt market.

The table below illustrates the prevailing PWLB rates and forecasts to Quarter 4 (December) 2011. The forecasts are as at 30 January 2010 and are provided by Sector Treasury Services Ltd.

| **Long Term Borrowing Rates - PWLB Maturity Loan Interest Rates** | | | |
|---|---|---|---|
| | **10 Years** | **25 Years** | **50 Years** |
| | **%** | **%** | **%** |
| **2010** | | | |
| Forecast Quarter 1 | 4.00 | 4.55 | 4.60 |
| Forecast Quarter 2 | 4.05 | 4.65 | 4.70 |
| Forecast Quarter 3 | 4.15 | 4.70 | 4.75 |
| Forecast Quarter 4 | 4.30 | 4.80 | 4.90 |
| | | | |
| **2011** | | | |
| Forecast Quarter 1 | 4.45 | 4.90 | 5.00 |
| Forecast Quarter 2 | 4.60 | 5.00 | 5.10 |
| Forecast Quarter 3 | 4.80 | 5.05 | 5.15 |
| Forecast Quarter 4 | 4.90 | 5.10 | 5.20 |

Due to the external interest rate environment, the LOBO market is not currently widely available to local authorities, and as a result LOBO rates are not being published at the present time.

## 8. Sensitivity of Forecasts

In normal times the main sensitivities of the forecast are likely to be the two scenarios below. Officers, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of view:

- If it were felt that there was a significant risk of a sharp rise in long and short term rates, perhaps arising from a greater than expected increase in world economic activity or further increases in inflation, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be used whilst interest rates were still relatively cheap.

- If it were felt that there was a significant risk of a sharp fall in long and short term rates, due to e.g. growth rates weakening, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term funding will be considered.

The borrowing and investment market remains very subdued at the present time. Borrowing has recently been undertaken (January 2010) at current rates in anticipation of future rate increases. Internal borrowing to support capital expenditure in the current environment of low investment returns is also being utilised.

Because of the Council's relatively low debt position and the unlikelihood of having to undertake further external borrowing to fund the capital programme expenditure until 2012-13, the impact on the Council of changes to interest rate forecasts related to new borrowing is not significant in the same way as that of investments – see Section 22 below.

A significant proportion of around 77% of the Council 's long-term debt is in the form of Money Market LOBO (Lenders Option, Borrowers Option) loans. Officers consider that the degree of risk on these loans in the current interest rate environment is low.

## 9. Borrowing Strategy

The Prudential Code requires that where there is a significant difference between the net and the gross borrowing position, the risks and benefits associated with this strategy should be clearly stated in the annual strategy.

The Council has a significant excess of investments over borrowings. Average values forecast for 2010-11 are £57.4m and £31.4m respectively, making a negative difference of £26m between gross debt and net debt after deducting cash balances.

The Council aims to reduce the difference between the two debt levels over the next three years in order to reduce the credit risk incurred by holding investments. The use of internal borrowing in recent years has already reduced substantially the level of credit risk and this will continue. Another factor that will be carefully considered is the difference between borrowing rates and investment rates to ensure the Council obtains value for money once an appropriate level of risk management has been attained to ensure the security of its investments.

There are benefits and risks to the use of internal and external borrowing. In the current interest rate environment these are as follows:

- Over the next three years, investment rates are 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 would maximise short-term savings.
- However, short term savings by avoiding new long term external borrowing must also be weighed against the potential for incurring additional long term extra costs by delaying unavoidable new external borrowing until later years when long term rates are forecast to be significantly higher

In view of these factors a combination of both internal and external borrowing will be used to finance the capital programme funding requirements of the next three years.

Internal borrowing – This is the management of cash flows, using funds from maturing investments within the financial year, to finance capital programme expenditure. As long term borrowing rates are currently higher than rates on investment income and look likely to remain so in the short term, this is a viable strategy. The running down of investments also has benefits of reducing exposure to interest rate and credit risk. Internal borrowing of around £5.5m over the next three years is anticipated, and this has been built into cash flow and debt financing budget forecasts.

External borrowing - Once the affordability of external borrowing to finance capital programme funding requirements has been established and the balanced capital programme and revenue budgets approved, decisions about when to borrow are driven by the forecasts on interest rates. Advice is sought from the Council's treasury management advisors before entering into any long-term loan arrangements.

All long-term external borrowing requires the express approval of the Chief Finance Officer, who should also sign any associated internal or external approval or authorisation documentation. The Chief Finance Officer has the delegated authority to take the most appropriate form of borrowing from approved sources.

£6m of new borrowing with the Public Works Loans Board has been undertaken in 2009-10, in anticipation of capital programme expenditure during the current and following two years as current borrowing rates are at a low point compared with forecasts. This comprised fixed rate maturity loans of £2m to January 2016, £2m to January 2017 and £2m to January 2018 at rates of 3.47%, 3.75% and 3.97% respectively. The Council's strategy is to replace these with longer-term loans on expiry or when longer-term rates are at a sufficiently low level.

It is anticipated that external borrowing of a further amount of £8m will be required in 2012-13, and this has been built into cash flow and debt financing budget forecasts.

## 10. Prudential Indicators

The proposed prudential indicators that relate to the Capital Financing and Borrowing Strategy are set out below. These are included in a separate report to Cabinet. Full explanations for each of the indicators can be found in Annex B of the Prudential Indicators for Capital Finance 2010-11 to 2012-13.

***Authorised limit for total external debt***

The proposed authorised limit for total external debt gross of investments for the forthcoming, and following two financial years is:

| Authorised limit for external debt | | | |
|---|---|---|---|
| | 2010-11 | 2011-12 | 2012-13 |
| | Limit £000 | Limit £000 | Limit £000 |
| Borrowing | 48,000 | 48,000 | 53,000 |
| Other long-term liabilities | 2,000 | 2,000 | 2,000 |
| TOTAL | 50,000 | 50,000 | 55,000 |

### *Operational boundary for total external debt*

The proposed operational boundary for total external debt for the forthcoming, and following two financial years is:

| Operational boundary for external debt | | | |
|---|---|---|---|
| | 2010-11 | 2011-12 | 2012-13 |
| | Boundary £000 | Boundary £000 | Boundary £000 |
| Borrowing | 43,000 | 43,000 | 48,000 |
| Other long-term liabilities | 2,000 | 2,000 | 2,000 |
| TOTAL | 45,000 | 45,000 | 50,000 |

Other long-term liabilities, shown in both tables above, relate to finance leases, which are currently at negligible values, but which may increase with the introduction of IFRS related accounting changes.

## 11. Treasury Indicators

The proposed treasury indicators that relate to the Capital Financing and Borrowing Strategy are set out below. These indicators were previously treated as prudential Indicators, but the revised codes and guidance now require them to be included in the Treasury Strategy as treasury indicators.

### *Maturity Structure of Borrowing*

This represents the amount of projected borrowing that is fixed rate maturing in each period expressed as a percentage of total projected borrowing that is fixed rate at the start of the period where the periods in question are:

- Under 12 months;
- 12 months and within 24 months;
- 24 months and within 5 years;
- 5 years and within 10 years;
- 10 years and above.

This sets both upper and lower limits with respect to the maturity structure of the Council’s borrowing.

The proposed limits for the forthcoming year are:

| Maturity structure of borrowing | | |
|---|---|---|
| | Lower Limit % | Upper Limit % |
| Under 12 months | 0% | 25% |
| 1-2 years | 0% | 25% |
| 2-5 years | 0% | 50% |
| 5-10 years | 0% | 100% |
| Over 10 years | 0% | 100% |

LOBO loans of £15.6m, just below 50% of the portfolio, are due for repayment in 2014-15, within the 2 to 5 year period. Officers are investigating options to manage this, and will consult with the Council's treasury advisers to determine whether it is prudent to let these loans run their full course or to repay or reschedule them.

Risk – The debt maturity profile is actively managed to ensure that debt maturity is prudently spread across future years. This ensures that the Council can properly plan for the maturity of its borrowings, and is not exposed to unmanageable risks.

## 12. Affordable Borrowing Limit

The Local Government Act 2003 and supporting regulations require the Council to determine and keep under review how much it can afford to borrow. The amount determined is termed the "Affordable Borrowing Limit". This is equivalent to the authorised limit at Section 10 above.

| Affordable Borrowing Limit | | |
|---|---|---|
| 2010-11 Limit £000 | 2011-12 Limit £000 | 2012-13 Limit £000 |
| 50,000 | 50,000 | 55,000 |

Accounting regulations allow local authorities to forward funding for their capital programmes up to a maximum of three years. The affordable borrowing limit figures include a provision for future forward funding should it be advantageous to do so.

Cabinet are asked to recommend to Council that they approve the Affordable Borrowing Limits for 2010-11 to 2012-13.

## 13. Temporary Borrowing

The Council may occasionally undertake short-term temporary borrowing if this is needed to cover its cash flow position. The maximum amount of temporary borrowing that the Council will borrow from any one counterparty will be £5m.

In addition, under long standing arrangements, the Council manages deposits from two local organisations. Formal agreements were set up with these organisations from 1st April 2009. These contain the following operational arrangements:

- Interest rates set in line with the average rate of interest achieved by the Council in the preceding period, less 0.5%
- Quarterly review of interest rates
- Withdrawal notice periods of 7 days
- Termination notice of 7 days

## 14. Overdraft Facilities

The Council has a £200k overdraft facility with its bankers, the Co-operative Bank, for which an annual fee of 0.25% (£500) applies. The overdraft rate applicable to use of the agreed facility is 2% above base rate. Borrowing in excess of the agreed facility is charged at 5% above base rate.

The overdraft facility is only used to cover unforeseen events; usage is kept to a minimum and generally occurs only as a result of events outside of the Council's control; for example, failure by third parties to make agreed payments. The use of the overdraft facility is monitored on a daily basis and reported monthly to senior managers through the performance reporting framework. Performance against target has improved significantly during 2009-10 due to the application of more efficient and robust cashflow monitoring processes.

# Investment Strategy

### 15. Current Investment Portfolio

The investment portfolio as at 31 January 2010, including deposit and call accounts, was as follows:

| | £m | % |
|---|---|---|
| | | |
| Banks outside the UK with sovereign (country) ratings of AAA | 13.0 | 20.1 |
| UK banks and building societies supported by the UK banking system support package | 14.2 | 21.9 |
| UK nationalised or part nationalised banking institutions | 29.6 | 45.7 |
| Debt Management Office | 1.0 | 1.5 |
| Other Local Authorities | 7.0 | 10.8 |
| | | |
| Total | 64.8 | 100 |

The portfolio includes a small amount placed with the Council's own bankers, the Co-operative Bank as at 31st January 2010. Amounts are placed with the Co-op Bank for operational purposes only as the bank does not currently meet the Council's investment counterparty criteria.

### 16. Specified/Non specified Investments

Under the Local Government Act 2003 the Council is required to have regard to the CLG (formerly ODPM) Guidance on Local Government Investments issued in March 2004 and CIPFA's Treasury Management in the Public Services Code of Practice (Fully Revised Second Edition 2009) and updated Guidance Notes (Fully Revised Third Edition 2009).

The CLG Guidance on Local Government Investments requires that investments are split into two categories:

(i) Specified investments – broadly, sterling investments, not exceeding 364 days and with a high credit rating.

(ii) Non-specified investments – do not satisfy the conditions for specified investments. This may include investment products that would normally be considered as specified investments, but are judged to have a higher level of risk than normal attached to them.

The detailed conditions attached to each of these categories are set out in the TMPs at Annex C.

Updated CLG Guidance on Local Government Investments is due to be published in 2010, with an implementation date of 1 April 2010.

## 17. Investment Strategy

The Council's appetite for risk must be clearly identified in its strategy report. The Council affirms that priority will be given to the security of capital and liquidity when investing funds. This will be carried out by strict adherence to the risk management and control strategies set out in the Schedules to the Treasury Management Practices and the Treasury Management Strategy.

Responsibility for risk management and control lie within the Council and cannot be delegated to an outside organisation.

The Council's counterparty and credit risk management policies are set out at the Schedule to the TMP1 Risk Management (Credit and counterparty risk management) and its approved instruments for investments are set out at the Schedule to TMP 4 Approved Instruments, Methods and Techniques. These, taken together, form the fundamental parameters of the Council's Investment Strategy

***Specified Investments***

The majority of the Council's investments in 2010-11 will fall into the category of specified investments.

Further counterparty limits may be put in place to minimise risk to the authority (see Section 18 below)

***Non-Specified Investments***

Prior to the start of each financial year officers review which categories of non-specified investments they consider could be prudently used in the coming year. The officer recommendation for 2010-11 is that long-term investments (those for periods exceeding 364 days) could prudently be used where interest rates are favourable and funds are not required for short-term cashflow management. This is subject to an evaluation of counterparty and other risk.

Advice will be taken from the Council's external treasury advisors before entering into any long-term investments.

Only counterparties in the Council’s current approved counterparty list that have limits of over 364 days will be used for such investments.

Any overall stricter limits in force in the Council’s investment counterparty policies at any time will take precedence.

The maximum amount that the Council will hold at any time during the year as long-term investments is £8.5m. This is just below 15% of the forecast average level of total investments in 2010-11, which is around £57m. This level of longer-term investment could be undertaken without having an adverse effect on the required liquidity of cashflow.

***Capital Expenditure***

The Council may make loans to third parties for the purpose of capital expenditure as allowable under paragraph 25 (1) (b) of the Local Authorities (Capital Financing and Accounting) (England) Regulations 2003 (Statutory Instrument No. 3146)

**18. Counterparties**

Policies for the management of counterparty and credit risk are set out at Section 1 of the Schedule to TMP 1, attached to the accompanying Cabinet report at Annex C.

The Council’s approach to counterparties for 2010-11 is set out below:

The Chief Finance Officer (CFO) will use the recommendations of the creditworthiness service provided by the Council’s external treasury advisers to determine suitable counterparties and the maximum period of investment, using the ratings assigned.

The CFO will determine, in the context of the above, and taking into account appropriate risk management factors:

- Any further criteria to be put in place to determine suitable counterparties
- The maximum investment amount to be held with each type of counterparty assigned a rating
- The maximum investment period with each type of counterparty assigned a rating

| | **Investments may be placed with counterparties within the maximum periods recommended by the Council's external treasury advisors, and which meet the following criteria:** | **Additional limits** |
|---|---|---|
| (1) | Counterparties having sovereign ratings of AAA (Overseas or UK) | NBC **additional limits** in force will be £12m and a maximum of 12 months (364 days). |
| | Or: | |
| (2) | UK nationalised or part nationalised banking institutions | NBC **additional limits** in force will be £15m and a maximum of 12 months (364 days). |
| | Or; | |
| (3) | UK banks or building societies supported by the UK banking system support package | NBC **additional limits** in force will be £15m and a maximum of 2 years (729 days). |

A schedule is attached at Annex D of counterparties that meet the criteria above as at 31 January 2010. This schedule is at a particular point in time and is subject to change according to changes in credit ratings and other economic and market data. Maximum investment periods (currently from 3 months to 364 days) will also vary for individual counterparties for the same reasons. The inclusion or exclusion of counterparties from this schedule is entirely a reflection of the Council's investment criteria, which may differ from those of other organisations.

It should be noted that the inclusion of counterparties in a counterparty list does not necessarily mean that they will be in the market for investment deals at any one point in time.

For the purposes of setting limits, institutions within the same banking group (eg Lloyds Banking Group) will be treated as a single counterparty.

Investments may also be placed with other local authorities and with the Government Debt Management Office (DMO). The limits will be £15m, for periods of up to 364 days.

The maximum percentage of the portfolio that may be placed with overseas counterparties at any one time is 50%.

Other investments that fall within the category of specified investments as set out in the schedule to TMP4 may also be made, up to a limit of £12m and 364 days with any individual counterparty. Any type of specified investment that has not been used by the Council within the previous twelve-month period will only be entered into after consultation with the Council's external treasury management advisors, and with the express approval of the Chief Finance Officer.

Deposits may be placed with the Council's own bankers, the Co-operative Bank plc. These will generally be for small amounts of up to £100k. However amounts of up to £5m may be placed for periods of up to a week for operational purposes should the need arise.

The Chief Financial Officer has discretion during the financial year to lift or increase the restrictions on the counterparty list and/or to adjust the associated lending limits on values and periods should it become necessary to enable the effective management of risk in relation to investments. At all times the Council's minimum level of credit risk, as set out at the Schedule to TMP1, will be met.

The total value of investments over 364 days at any one time is restricted by the treasury indicator for the upper limit on investments for periods longer than 364 days (See Section 24 below). For 2010-11 this is £8.5m.

## 19. Liquidity of Investments

Most short-term investments are held for cashflow management purposes and officers will ensure that sufficient levels of short-term investments and cash are available for the discharge of the Council's liabilities. Investment periods range from overnight to 364 days as specified investments or longer as a non-specified investment.

The average period of each new investment in the current financial year, as at 31 January 2010 is 79 days. When deciding the length of each investment, regard is had to both cashflow needs and prevailing interest rates.

For short term and overnight investment the Council makes full use of appropriate bank call and deposit accounts offering competitive rates and in most instances instant access to funds.

As referred to in Section 17 above, it is recommended that a maximum total of £8.5m be invested for periods exceeding 364 days (if interest rates are favourable) and in accordance with counterparty limits. The balance of funds will be held as short-term investments (under 365 days).

## 20. Bank Base Rates

The bank base rate has been held steady at its current all time low of 0.50% since March 2009, whilst the Bank of England has pursued its alternative course of quantitative easing.

The current interest rate view of Council's treasury management advisors is that bank base rate will gradually begin to rise from current levels from the third quarter of 2010 as the economy starts to gather speed in its recovery from the global recession.

The rate is then expected to continue a steady rise until it reaches 4.5% in Q1 2013. There is downside risk to these forecasts if the recession proves to be deeper and more prolonged than currently expected.

The table below shows the Council's treasury advisors forecast bank base rates for 2010 to 2012:

| **Base Rate** | **2010 Forecast** | **2011 Forecast** | **2012 Forecast** |
|---|---|---|---|
| | | | |
| Quarter 1 | 0.50% | 1.50% | 3.50% |
| Quarter 2 | 0.50% | 2.25% | 3.75% |
| Quarter 3 | 0.75% | 2.75% | 4.25% |
| Quarter 4 | 1.00% | 3.25% | 4.25% |

## 21. Short Term Interest Rates for Investments

Short-term interest rates for investments tend to be linked to the bank base rate levels, and in the current economic climate these are abnormally low, and forecast to remain so for some time.

The Council's treasury advisors have advised that the Council should budget for an investment return of 1% on investments placed during 2010-11. Officers have reduced this by a further 0.25% to build in a contingency to allow for prudent budgeting.

The rate of return used to build the debt-financing budget for 2009-10 was 2%, and the average rate of return to 31 December 2009 was 1.82%. The reduction in rates over the high levels of previous years (in 2007-08 the average rate of return was 5.26%) has had a significant impact on the forecast of income from investments.

In 2010-11, at an average forecast balance of £57.4m, the loss of income is around £574k per 1% reduction in rates. As some of the cash being invested relates to HRA balances, a proportion of the impact is passed on to the HRA and offset against the HRA subsidy calculations; the remaining balance has a direct hit on the General Fund budget.

The impacts of the interest rate reductions have been included in the 2010-11 debt-financing budget included in the Council's Revenue Budget 2010-11 to 2012-13 report.

## 22. Sensitivity of Forecasts

The amount that can be earned on interest on investments is sensitive to changes in the prevailing interest rates. This is particularly marked in the current economic climate. Officers have budgeted prudently, and the rates achievable on investments are currently so low that it is unlikely that they would drop further, so any swing would more likely be towards the upside.

Officers, in conjunction with the Council's treasury advisors, will continually monitor both the prevailing interest rates and market forecasts, taking corrective action as required.

Any impact on the debt-financing budget of changes in forecast returns will be reported to Cabinet as part of the monthly revenue budget monitoring reporting.

## 23. Prudential Indicators

There are no prudential indicators that relate specifically to the Investment Strategy.

## 24. Treasury Indicators

The proposed treasury indicators that relate to the Investment Strategy are set out below. These indicators were previously treated as prudential Indicators, but the revised codes and guidance now require them to be included in the Treasury Strategy as treasury indicators.

***Upper limits on interest rate exposures***

The Council must set for the forthcoming financial year and the following two financial years, upper limits to its exposure to the effect of changes in interest rates. These limits relate to both fixed interest rates and variable interest rates, and are referred to as the upper limits on fixed interest rate and variable interest rate exposures.

These limits can be expressed either as absolute amounts or as a percentage. They may be related either to the authority's net principal sum outstanding on its borrowing/investments or to the net interest on these. The Council has chosen to work to a limit represented as an absolute amount of principal sums. Officers consider this to be the most transparent and straightforward method.

The treasury management guidance states that where in doubt borrowing and investments should be treated as being at variable rates for the purposes of these indicators. With this in mind, borrowing in the form of LOBOs (Lenders Option, Borrowers Option) has been treated as being at variable rates, as the rates are reviewed at agreed intervals of typically 6 months or a year. Additionally, money market investments of less than one year at fixed rates are treated as variable rate investments due to their short-term nature.

Since the Council has a significant excess of investments over debt, both calculations should result in a negative figure. The upper limit has therefore been set at zero – i.e. a positive result representing an excess of fixed or variable rate debts over fixed or variable rate investments would exceed the limit.

Proposed upper limits on interest rate exposures for the forthcoming, and following two financial years are therefore:

| Upper limits on interest rate exposures | | |
|---|---|---|
| | Fixed Interest Rate Exposures £000 | Variable Interest Rate Exposures £000 |
| 2010-11 | 0 | 0 |
| 2011-12 | 0 | 0 |
| 2012-13 | 0 | 0 |

**Total principal sums invested for periods longer than 364 days**

Under the Local Government Act 2003 and the CLG (formerly ODPM Guidance on Local Authority Investments 2004, all Councils are now permitted to invest for periods exceeding 1 year (or 364 days). The Council is required to set a limit to the level of such investments it might wish to make.

This limit can be expressed as a percentage or as an absolute amount (i.e. a monetary figure). The Council has chosen to work to a limit represented as an absolute amount as officers consider this to be the most transparent and method and the more straightforward to monitor.

The limit has been set at a level that would allow for monies not anticipated to be spent in year e.g. capital receipts, to be invested for longer periods if interest rates are favourable.

The proposed limits for the forthcoming, and following two financial years are as follows.

| Upper limit on investments for periods longer than 364 days | |
|---|---|
| | Upper Limit £000 |
| 2010-11 | 8,500 |
| 2011-12 | 7,000 |
| 2012-13 | 6,500 |

Risk analysis – This upper limit has been set at a prudent level (below 15% of forecast total external investments in each year) in order not to compromise cash flow liquidity.