Appendix 1

Treasury Management Strategy Statement and Investment Strategy 2010/11 to 2012/13

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Appendices

1. Background

1.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") requires local authorities to determine the Treasury Management Strategy Statement (TMSS). This statement also incorporates the Investment Strategy. Together, these cover the financing and investment strategy for the forthcoming financial year.

In response to the financial crisis in 2008 and the collapse of the Icelandic banks, CIPFA has revised the TM Code and Guidance Notes as well as the Prudential Indicators. Communities and Local Government (CLG) is also in the process of revising and updating the Investment Guidance. The Mid Year report is to reflect any changes to the Strategy and best practice.

1.2 CIPFA has defined Treasury Management as:

"the management of the organisation's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

1.3 The Council is responsible for its treasury decisions and activity. No treasury management activity is without risk. The successful identification, monitoring and control of risk is an important and integral element of its treasury management activities. The main risks to the Council's treasury activities are:

- Liquidity Risk (Adequate cash resources)
- Market or Interest Rate Risk (Fluctuations in the value of investments)
- Inflation Risk (Exposure to inflation)
- Credit and Counterparty Risk (Security of Investments)
- Refinancing Risk (Impact of debt maturing in future years)
- Legal & Regulatory Risk (Compliance with statutory and regulatory requirements)

2. Balance Sheet and Treasury Position

2.1 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). The estimates, based on the current Revenue Budget and Capital Programmes, are set out below:

	31/03/10 Estimate £'000	31/03/11 Estimate £'000	31/03/12 Estimate £'000	31/03/13 Estimate £'000
CFR	9,157	9,121	9,113	9,113
Usable Capital Receipts	(28,966)	(23,687)	(28,673)	(27,172)
Balances & Reserves	(5,590)	(5,103)	(5,006)	(4,903)
Net Balance Sheet Position	(25,399)	(19,669)	(24,566)	(22,962)

2.2 The Council's level of physical debt and investments is linked to these components of the Balance Sheet. The current portfolio position is set out at Appendix A. Market conditions, interest rate expectations and credit risk considerations will influence the Council's strategy in determining the borrowing and investment activity against the underlying Balance Sheet position.

2.3 As the CFR represents the level of borrowing (currently nil) for capital purposes and revenue expenditure cannot be financed from borrowing, net physical external borrowing should not exceed the CFR other than for short term cash flow requirements. It is permissible under the Prudential Code to borrow in advance of need up to the level of the estimated CFR over the term of the Prudential Indicators. Where this takes place the cash will form part of the invested sums until the related capital expenditure is incurred. This being the case net borrowing should not exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years other than in the short term due to cash flow requirements.

2.4 The move to International Financial Reporting Standards (IFRS) has implications for the Capital Financing Requirement components on the Balance Sheet. Analysis of the Council's Operating leases against IFRS requirements may result in the related long term assets and liabilities being brought onto the Council's Balance Sheet. The estimates for the CFR and Long Term Liabilities will therefore need to take into account such items. This will influence the determination of the Council's Affordable Borrowing Limit and Operational Boundary.

2.5 The estimate for interest payments in 2010/11 is nil and for interest receipts is £1,430,620.

3. Outlook for Interest Rates

3.1 The economic interest rate outlook provided by the Council's treasury advisor, Arlingclose Ltd, is attached at Appendix C. Financial markets remain reasonably volatile as the structural changes necessary within economies and the banking system evolve. This volatility provides opportunities for active treasury management. The Council will reappraise its strategy from time to time and, if needs be, realign it with evolving market conditions and expectations for future interest rates.

4. Borrowing Requirement and Strategy

4.1 The CFR represents the cumulative capital expenditure of the local authority that has not been financed. To ensure that this expenditure will ultimately be financed, local authorities are required to make a Minimum Revenue Provision for Debt Redemption (MRP) from within the Revenue budget each year.

4.2 Capital expenditure not financed from internal resources (i.e. Capital Receipts, Capital Grants and Contributions, Revenue or Reserves) will produce an increase in the CFR (the underlying need to borrow) and in turn produce an increased requirement to charge MRP in the Revenue Account.

4.3 Physical external borrowing may be greater or less than the CFR, but in accordance with the Prudential Code, the Council will ensure that net external borrowing does not, except in the short term, exceed the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years.

4.4 The cumulative estimate of the maximum long-term borrowing requirement is estimated by comparing the projected CFR with the profile of the current portfolio of external debt and long term liabilities over the same financial horizon, as follows:

	31/03/2010 Estimate £'000	31/03/2011 Estimate £'000	31/03/2012 Estimate £'000	31/03/2013 Estimate £'000
Capital Financing Requirement (CFR)	9,157	9,121	9,113	9,113
Less: Existing Profile of Borrowing and Other Long Term Liabilities	44	8	0	0
Cumulative Maximum External Borrowing Requirement	9,113	9,113	9,113	9,113
Balances & Reserves	(5,590)	(5,103)	(5,006)	(4,903)
Cumulative Net Borrowing Requirement (Call on capital receipts)	3,523	4,010	4,107	4,210

4.5 The Council's strategy is to maintain maximum control over any potential long term borrowing activities as well as flexibility on its loans portfolio. Capital expenditure levels, market conditions and interest rate levels will be monitored during the year in order to minimize borrowing costs over the medium to longer term (should SSDC decide to borrow). A prudent and pragmatic approach to borrowing will be maintained to minimise borrowing costs without compromising the longer-term stability of the portfolio, consistent with the Council's Prudential Indicators.

4.6 In conjunction with advice from its treasury advisor, Arlingclose Ltd, the Council will keep under review the options it has in borrowing from the PWLB, the market and other sources identified in the Treasury Management Practices Schedules, up to the available capacity within its CFR and Affordable Borrowing Limit (defined by CIPFA as the Authorised Limit).

The outlook for borrowing rates:

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

4.8 The difference between investment earnings and debt costs, (despite long term borrowing rates being around historically low levels), remains high and this is expected to remain a feature during 2010/11. The so-called "cost of carry" associated with long term borrowing compared to temporary investment returns means that the appetite for new long term borrowing brings with it additional short-term costs.

4.9 PWLB variable rates have fallen below 1%. They are expected to remain low as the Bank Rate is maintained at historically low levels to enable the struggling economy to emerge from the recession. Against a backdrop of interest rates remaining lower for longer, a passive borrowing strategy i.e. borrow long term funds as they are required may be appropriate. Equally, variable rate funds or EIP (equal installments of principal) loans that mitigate the impact should be considered if the Council undertakes long-term borrowing.

4.10 The PWLB remains the preferred source of borrowing given the transparency and control that its facilities continue to provide.

4.11 The Council will undertake a financial options appraisal before any borrowing is made.

4.12 For any borrowing that may be undertaken in advance of need the Council will adopt the same rigorous policies and approach to the protection of capital as it does for the investment of its surplus balances.

5. Investment Policy and Strategy

Background

5.1 Guidance from CLG on Local Government Investments in England requires that an Annual Investment Strategy (AIS) be set.

Investment Policy

5.2 To comply with the CLG's guidance, the Council's general policy objective is to invest its surplus funds prudently. The Council's investment priorities are:

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

The CLG's recent (draft) revised Guidance on investments reiterates security and liquidity as the primary objectives of a prudent investment policy. The speculative procedure of borrowing purely in order to invest is unlawful.

5.3 Investments are categorised as 'Specified' or 'Non Specified' investments based on the criteria in the CLG Guidance. Potential instruments for the Council's use within its investment strategy are contained in Appendix D.

5.4 The credit crisis has refocused attention on the treasury management priority of security of capital monies invested. The Council will continue to maintain a counterparty list based on its criteria and will monitor and update the credit standing of the institutions on a regular basis. This assessment will include credit ratings and other alternative assessments of credit strength.

5.5 The Council's current level of investments is presented at Appendix A.

Investment Strategy

5.6 The global financial market storm in 2008 and 2009 has forced investors of public money to reappraise the question of risk versus yield. Income from investments is a key support in the Council's budget.

5.7 The UK Bank Rate has been maintained at 0.5% since March 2009. Short-term money market rates are likely to remain at very low levels which will have a significant impact on investment income. The Medium Term Financial Plan has been updated to reflect the impact of long term low interest rates to ensure that the security of the sums invested are paramount.

5.8 The Assistant Director (Finance and Corporate Services), under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on the core investment portfolio will be reported to the Audit Committee on a quarterly basis.

Investments managed in-house:

5.9 The Council's shorter term cash flow investments are made with reference to the outlook for the UK Bank Rate and money market rates.

5.10 In any period of extreme instability in the markets, the default position is for investments to be made with the Debt Management Office.

5.11 The table below shows the strategic approach to treasury management and the overall portfolio should include investments within the following ranges dependant on overall economic conditions:

	%
Fund Managers and pooled managed funds	0% - 25%
Term Deposits (up to 2 years)	0% - 75%
3 – 5 year cash deposits	0% - 25%
1 – year callable deposits	0% - 15%
1 – 10 year Eurosterling/Corporate Bonds	0% - 75%

5.12 This approach aims to promote a diverse mix of investments with funds placed aiming to give some measure of certainty and stability. The main aim however will be to minimise risk.

5.13 In 2009/10 the Council restricted its investment activity to:

- The Debt Management Agency Deposit Facility (The rates of interest from the DMADF are below equivalent money market rates. However, the returns are an acceptable trade-off for the guarantee that the Council's capital is secure)
- AAA-rated Money Market Funds with a Constant Net Asset Value (CNAV)
- Deposits with other local authorities
- Business reserve accounts and term deposits. *These have been primarily restricted to UK institutions that are rated at least A+ long term (or equivalent), and have access to the UK Government's 2008 Credit Guarantee Scheme (CGS)*
- Bonds issued by Multilateral Development Banks

Please see Appendix D for a breakdown of current counterparties, instruments and limits used.

5.14 Conditions in the financial sector have begun to show signs of improvement, albeit with substantial intervention by government authorities. In order to diversify the counterparty list, the use of comparable non-UK Banks for investments is now considered appropriate.

The sovereign states whose banks are to be included are Australia, Canada, Finland, France, Germany, Netherlands, Spain, Switzerland and the US. These countries, and the Banks within them (see Appendix D/E), have been selected after analysis and careful monitoring of:

- Credit Ratings (minimum long-term A+)
- Credit Default Swaps
- GDP; Net Debt as a Percentage of GDP

- Sovereign Support Mechanisms / potential support from a well-resourced parent institution
- Share Price

The Council has also taken into account information on corporate developments and market sentiment towards the counterparties. The Council and its Treasury Advisors, Arlingclose, will continue to analyse and monitor these indicators and credit developments on a regular basis and respond as necessary to ensure security of the capital sums invested.

This modest expansion of the counterparty list is an incremental step. In order to meet requirements of the revised CIPFA Treasury Management Code, the Council is focusing on a range of indicators (as stated above), not just credit ratings.

Limits for Specified Investments are set out in Appendix D/E.

5.15 To protect against a prolonged period of low interest rates, 1-year deposits and longer-term secure investments will be actively considered within the limits the Council has set for Non-Specified Investments (see Appendix D). The longer-term investments will be likely to include:

- **Supranational bonds (bonds issued by multilateral development banks):** The joint and individual pan-European government guarantees in place on these bonds provide security of the principal invested. Even at the lower yields likely to be in force, the return on these bonds will provide certainty of income against an outlook of low official interest rates. At 31/1/10, the Council has £9m invested in such bonds

- **UK government guaranteed bonds and debt instruments issued by banks/building societies:** The UK Government's 2008 Credit Guarantee Scheme permits specific UK institutions to issue short-dated bonds with an explicit government guarantee. The bonds are issued at a margin over the underlying gilt and would be a secure longer-term investment option. (*Please note that these bonds would, under existing statute, be capital expenditure investments*.)

<u>Investments managed externally</u>

Currently the Council has no externally managed funds. However the following may be used once fully evaluated and with advice from Arlingclose;

5.16 Funds managed on a segregated basis: the Council will continue to evaluate funds managed externally. Fund Managers may be able to add value through the use of investments contained in Appendix D

5.17 Collective Investment Schemes (Pooled Funds): The Council will continue to evaluate the use of Pooled Funds and determine the appropriateness of their use within the investment portfolio. Pooled funds enable the Council to diversify the assets and the underlying risk in the investment portfolio and provide the potential for enhanced returns.

6. Balanced Budget Requirement

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

7. 2010/11 MRP Statement

Background:

7.1 For many years local authorities were required by Statute and associated Statutory Instruments to charge to the Revenue Account an annual provision for the repayment of debt associated with expenditure incurred on capital assets. This charge to the Revenue Account was referred to as the Minimum Revenue Provision (MRP). In practice MRP represents the financing of capital expenditure from the Revenue Account that was initially funded by borrowing.

7.2 In February 2008 the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 [Statutory Instrument 2008/414] were approved by Parliament and became effective on 31 March 2008. These regulations replaced the formula based method for calculating MRP which existed under previous regulations under the Local Government Act 2003. The new regulations required a local authority to determine each financial year an amount of MRP which it considers to be prudent. Linked to this new regulation, the Department of Communities and Local Government (CLG) produced Statutory Guidance which local authorities are required to follow, setting out what constitutes a prudent provision.

7.3 The CLG Guidance recommends that before the start of the financial year, a statement of MRP policy for the forthcoming financial year is approved by the Full Council.

7.4 The broad aim of the Policy is to ensure that MRP is charged over a period that is reasonably commensurate with the period over which the capital expenditure which gave rise to the debt provides benefits. In the case of borrowing supported by Revenue Support Grant, the aim is that MRP is charged over a period reasonably commensurate with the period implicit in the determination of that grant. Where a local authority's overall CFR is £nil or a negative amount there is no requirement to charge MRP.

7.5 The move to International Financial Reporting Standards (IFRS) means that Operating Leases may be brought on Balance Sheet. Where this is the case, such items are classed in accounting terms as a form of borrowing. CLG has therefore proposed amending the Capital Finance Regulations to ensure that the impact on the Revenue account is neutral, with MRP for these items matching the principal repayment embedded within the lease agreement.

MRP Options:

7.6. Four options for prudent MRP provision are set out in the CLG Guidance. Details of each are set out below:

Option 1 – Regulatory Method:

7.7 This method replicates the position that would have existed under the previous Regulatory environment. MRP is charged at 4% of the Authority's underlying need to borrow for capital purposes, however this option allows a historical adjustment to take place that is beneficial to some authorities.

Option 2 – CFR Method:

7.8 This method simplifies the calculation of MRP by basing the charge solely on the authority's CFR but excludes the technical adjustments included in Option 1. The annual MRP charge is set at 4% of the CFR at the end of the preceding financial year.

Option 3 – Asset Life Method:

7.9 Under this method MRP is determined by the life of the asset for which the borrowing is undertaken. This can be calculated by either of the following methods:

(a) Equal Installments: where the principal repayment made is the same in each year,

or

(b) Annuity: where the principal repayments increase over the life of the asset. The annuity method has the advantage of linking MRP to the benefits arising from capital expenditure, where these benefits are expected to increase over the life of the asset.

7.10 MRP commences in the financial year following that in which the expenditure is incurred or, in the year following that in which the relevant asset becomes operational. This enables an MRP "holiday" to be taken in relation to assets which take more than one year to be completed before they become operational.

7.11 The estimated life of the asset will be determined in the year that MRP commences and cannot be revised. However, additional repayments can be made in any year which will reduce the level of payments in subsequent years.

7.12 If no life can be reasonably attributed to an asset, such as freehold land, the life is taken to be a maximum of 50 years. In the case of freehold land on which a building or other structure is constructed, the life of the land will be treated as equal to that of the structure, where this would exceed 50 years.

7.13 In instances where central government permits revenue expenditure to be capitalised, the Statutory Guidance sets out the number of years over which the charge to revenue must be made.

7.14 MRP in respect of Operating Leases brought on Balance Sheet under IFRS falls under Option 3.

Option 4 - Depreciation Method:

7.15 The deprecation method is similar to that under Option 3 but MRP will is equal to the depreciation provision required in accordance with proper accounting practices to be charged to the Income and Expenditure account

MRP Policy for 2010/11:

7.17 It is proposed that for 2010/11 the Council adopts Option 3 – Asset Life Method. Option 3 enables the calculation of MRP to be aligned with the life of the asset. If it is ever proposed to vary the terms of this MRP Statement during the year, a revised statement will be made to Council at that time.

8. Reporting on the Treasury Outturn

The Assistant Director (Finance and Corporate Services) will report to Council on treasury management activity / performance as follows:

(a) Six monthly against the strategy approved for the year. *(please note that CIPFA requires as a minimum a mid-year and year end review of treasury activity).*
(b) The Council will produce an outturn report on its treasury activity no later than 30th September after the financial year end.
(c) Audit Committee will be responsible for the scrutiny of treasury management activity and practices.

9. Other Items

Training

CIPFA's revised Code requires the Assistant Director (Finance and Corporate Services) to ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

Officers tasked with treasury management responsibilities are engaged in regular financial and treasury training through attendance at selective seminars/workshops and treasury courses.

Treasury Consultants

The CLG's Draft revisions to its Guidance on local government investments recommend that the Investment Strategy should state:

- Whether and, if so, how the authority uses external contractors offering information, advice or assistance relating to investment and
- How the quality of any such service is controlled.

The Council appointed Arlingclose as its Treasury Advisers in 2005. The provision of treasury advisory services was formally re-tendered in autumn 2009 and Arlingclose was reappointed. Among the various services received is **advice** on capital financing, borrowing and investments appropriate to the Council's individual circumstance and objectives.

The Council monitors the service through measuring:

- The timeliness of advice
- The returns from investments
- The accuracy of technical advice
- Regular market testing
- Regular internal meetings to discuss performance
- Measurement through CIPFA's benchmarking club
- Direct access to a nominated advisor
- The quality and content of training courses

However, this doesn't divest the Council from its responsibility of its treasury decisions.

Publication

The CLG's Draft revisions to its Guidance on local government investments recommend that the initial strategy and any revised strategy should, when approved, be made available to the public free of charge, in print or online.

The Council makes available online its Treasury Management Strategies within the finance section of the website. This includes both the initial strategy as well as any revisions. Should any member of the public request a printed copy, this would be provided free of charge.

APPENDIX A

EXISTING PORTFOLIO PROJECTED FORWARD

	31/03/09 £'000	31/03/10 Estimate £'000	31/03/11 Estimate £'000	31/03/12 Estimate £'000	31/03/13 Estimate £'000
External Borrowing:	0	0	0	0	0
Existing long-term liabilities - Finance Leases	80	44	8	0	0
IFRS long-term liabilities: • Operating Leases (2010/11 onwards)	0	0	126	90	47
Total External Debt	**80**	**44**	**134**	**90**	**47**
Investments: *Managed in-house* • Deposits and monies on call and Money Market Funds	22,423	34,220	21,938	35,413	36,940
• Supranational bonds	10,993	9,682	7,581	4,331	1,150
• Corporate bonds	4,993	5,283	5,283		
Total Investments	**38,409**	**49,185**	**34,802**	**39,744**	**38,090**
(Net Borrowing Position)/ Net Investment position	**38,329**	**49,141**	**34,668**	**39,654**	**38,043**

APPENDIX B

PRUDENTIAL INDICATORS 2010/11 TO 2012/13

Background:

There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators.

Net Borrowing and the Capital Financing Requirement:

This is a key indicator of prudence. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that the net external borrowing does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

The Assistant Director Finance and Corporate Services reports that the authority had no difficulty meeting this requirement in 2009/10, nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

Prudential Indicator 1 - Capital Expenditure:

This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council. The actual expenditure for 2008/09 and the estimates of capital expenditure to be incurred for the current and future years are:

	2008/09 Actual £'000	**2009/10 Probable Outturn £'000**	**2010/11 Estimate £'000**	**2011/12 Estimate £'000**	**2012/13 Estimate £'000**
Approved capital schemes	7,391	5,757	8,649	2,275	1,387
Investments	5,000	0	0	0	0
Reserves	1,742	1,945	1,111	802	803
New Schemes for 2010/11 start	0	0	652	337	0
Total Expenditure	**14,133**	**7,702**	**10,412**	**3,414**	**2,190**

The figures in the later years are lower at this stage but will increase as anticipated capital projects are approved. Additional capital expenditure will also occur if new capital receipts are received and used to finance projects currently on the reserve list, as per the capital strategy.

Prudential Indicator 2 - Ratio of Financing Costs to Net Revenue Stream:

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure. This shows how much of the revenue budget is committed to the servicing of finance.

Estimates of the ratio of financing costs to net revenue stream for the current and future years, and the actual figures for 2008/09 are:

Portfolio	2008/09 Actual £'000	2009/10 Probable Outturn £'000	2010/11 Estimate £'000	2011/12 Estimate £'000	2012/13 Estimate £'000
Financing Costs*	(2,982)	(2,229)	(1,368)	(980)	(626)
Net Revenue Stream	19,735	20,109	20,310	21,793	22,542
%*	15.1	11.1	6.7	4.5	2.8

*Figures in brackets denote income through receipts or reserves.

The financing costs include interest payable, notional amounts set aside to repay debt, revenue contributions to capital less, interest on investment income. The figures are in brackets due to investment income outweighing financing costs significantly for SSDC. This shows the extent that the Council is dependent on investment income.

The percentages are falling as the revenue stream increases, i.e. the budget requirement is becoming larger and the investment income smaller as more capital is spent.

Prudential Indicator 3 - Capital Financing Requirement:

The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. Estimates of the year-end capital financing requirement for the authority are:

	2008/09 Actual £'000	2009/10 Probable Outturn £'000	2010/11 Estimate £'000	2011/12 Estimate £'000	2012/13 Estimate £'000
Opening CFR	9,229	9,193	9,157	9,121	9,113
Capital Expenditure	7,391	9,647	10,412	3,414	2,190
Capital Receipts*	(5,598)	(6,038)	(8,227)	(2,514)	(1,501)
Grants/Contributions*	(1,793)	(3,609)	(2,185)	(900)	(689)
MRP	(36)	(36)	(36)	(8)	
Closing CFR	9,193	9,157	9,121	9,113	9,113

*Figures in brackets denote income through receipts or reserves.

The capital financing requirement has changed due to the way we need to account for leases.

Prudential Indicator 4 – Net external Borrowing compared to the medium term Capital Financing Requirement:

The Council is also required to ensure that any medium term borrowing is only used to finance capital and therefore it has to demonstrate that the net external borrowing does not, except in the short term exceed the total of capital financing requirements over a three year period.

	2008/09 Actual £'000	2009/10 Probable Outturn £'000	2010/11 Estimate £'000	2011/12 Estimate £'000	2012/13 Estimate £'000
Net Borrowing*	(36,852)	(47,719)	(34,802)	(39,744)	(38,090)
CFR	9,193	9,157	9,121	9,113	9,113

*The figures in brackets show the estimated level of investments we currently have.

Prudential Indicator 5 - Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure:

The Council must set three years of upper limits to its exposure to the effects of changes in interest rates. As a safeguard, it must ensure that its limit would allow it to have up to 100% invested in variable rate investments to cover against market fluctuations. Overall the authority is aiming to keep within the following exposure to fixed rates as and when market conditions improve.

	2008/09 % Actual	**2009/10 %Probable Outturn**	**2010/11 % Limit**	**2011/12 % Limit**	**2012/13 % Limit**
Fixed	43.82	30.43	80	80	80
Variable	56.18	69.57	100	100	100

The Council must also set limits to reflect any borrowing we may undertake.

	2008/09 % Actual	**2009/10 % Probable Outturn**	**2010/11 % Limit**	**2011/12 % Limit**	**2012/13 % Limit**
Fixed	0	0	100	100	100
Variable	0	0	100	100	100

The indicator has been set at 100% to maximise opportunities for future debt as they arise.

Prudential Indicator 6 - Upper Limit for total principal sums invested over 364 days:

The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested.

Upper Limit for total principal sums invested over 364 days	2008/09 Actual £'000	2009/10 Probable Outturn £'000	2010/11 Estimate £'000	2011/12 Estimate £'000	2012/13 Estimate £'000
Between 1-2 years	4,037	10,659	25,000	25,000	25,000
Between 2-3 years	7,954	2,120	20,000	20,000	20,000
Between 3-4 years	4,948	1,061	10,000	10,000	10,000
Between 4-5 years	0	1,150	10,000	10,000	10,000
Over 5 years	0	0	5,000	5,000	5,000

The estimates are considerably higher than the actual balances held in 2008/09 and 2009/10 to ensure the Council has sufficient flexibility to deal with any unexpected events. **The overall limit for maturities of greater than 364 days will not exceed 70% of the portfolio.**

Prudential Indicator 7 - Actual External Debt:

This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

Actual External Debt as at 31/03/2009	£'000
Borrowing	0
Other Long-term Liabilities	80
Total	80

Prudential Indicator 8 - Authorised Limit for External Debt:

The Council has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy and practice. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Council and not just those arising from capital spending reflected in the CFR.

This limit represents the maximum amount that SSDC may borrow at any point in time during the year. If this is limit is exceeded the Council has acted ultra vires. It also gives the Council the responsibility for limiting spend over and above the agreed capital programme. The results for 2007/08 and 2008/09 show that this limit has not been used. A £9.1m borrowing requirement has been identified to finance the capital programme and further borrowing may be undertaken to increase our borrowing to this level if and when it is the most cost effective way of funding SSDC's requirements. A ceiling of £12 million for each of the next three years is recommended, to allow flexibility to support new capital projects over and above the identified borrowing requirement.

The move to local authorities implementing International Financial Reporting Standards (IFRS) has implications for the Capital Financing Requirement components on the Balance Sheet. Analysis of the Council's leases against IFRS implications may result in the related assets and liabilities having to be brought onto the Council's balance sheet. This will impact on estimates for the CFR which will need to be updated once this analysis has been completed. This may in turn require changes to the Council's Authorised Limit and the Operational Boundary which will require Council agreement and approval.

	2008/09 Actual £'000	2009/10 Probable Outturn £'000	2010/11 Estimate £'000	2011/12 Estimate £'000	2012/13 Estimate £'000
Borrowing	0	0	11,900	11,900	11,900
Other Long-term Liabilities	80	44	100	100	100
Total	80	44	12,000	12,000	12,000

Prudential Indicator 9 – Operational Boundary for External Debt:

The Operational Boundary sets the limit for short term borrowing requirements for cash flow and has to be lower than the previous indicator, the authorised limit for external debt. A ceiling of £10 million is recommended for each of the next three years. The table overleaf shows that SSDC's current borrowing is well within this limit. This indicator more than covers the capital financing requirement.

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

	2008/09 Actual £'000	2009/10 Probable Outturn £'000	2010/11 Estimate £'000	2011/12 Estimate £'000	2012/13 Estimate £'000
Borrowing	0	0	9,900	9,900	9,900
Other Long-term Liabilities	80	44	100	100	100
Total	80	44	10,000	10,000	10,000

Prudential Indicator 10 - Maturity Structure of Fixed Rate borrowing:

This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

Maturity structure of fixed rate borrowing	2008/09 % Actual	2009/10 % Probable Outturn	Lower Limit %	Upper Limit %
Under 12 months	0	0	0	100
12 months and within 24 months	0	0	0	100
24 months and within 5 years	0	0	0	100
5 years and within 10 years	0	0	0	100
10 years and within 20 years	0	0	0	100
20 years and within 30 years	0	0	0	100
30 years and within 40 years	0	0	0	100
40 years and within 50 years	0	0	0	100
50 years and above	0	0	0	100

Prudential Indicator 11 - Incremental Impact of Capital Investment Decisions:

SSDC must show the effect of its annual capital decisions for new capital schemes on the council taxpayer. Capital spend at SSDC is financed from additional receipts so the figures below actually show the possible decreases in council tax if all capital receipts were invested rather than used for capital expenditure.

Incremental Impact of Capital Investment Decisions	2008/09 Actual £	2009/10 Approved £	2010/11 Estimate £	2011/12 Estimate £	2012/13 Estimate £
Decrease in Band D Council Tax	0.99	0.92	0.20	0.29	0.28

Prudential Indicator 12 - Adoption of the CIPFA Treasury Management Code:

This indicator demonstrates that the Council has adopted the principles of best practice.

Adoption of the CIPFA Code of Practice in Treasury Management
The Council approved the adoption of the CIPFA Treasury Management Code at its Council meeting on 18th April 2002.

Arlingclose's Economic and Interest Rate Forecast

	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
Official Bank Rate													
Upside risk			+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	0.50	0.50	0.50	1.00	1.50	2.00	2.50	2.75	3.00	3.00	3.00	3.00	3.00
Downside risk				-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
1-yr LIBID													
Upside risk			+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	1.25	1.25	1.50	1.75	2.25	3.00	3.50	4.00	4.00	4.00	4.00	4.00	4.00
Downside risk				-0.25	-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
5-yr gilt													
Upside risk	+0.25	+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	2.70	2.80	2.90	3.00	3.25	3.50	3.75	4.00	4.25	4.25	4.25	4.25	4.25
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
10-yr gilt													
Upside risk		+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.50	+0.50	+0.50	+0.50
Central case	3.75	3.75	4.00	4.00	4.25	4.25	4.50	4.50	4.75	5.00	5.00	5.00	5.00
Downside risk		-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
20-yr gilt													
Upside risk	+0.25	+0.50	+0.50	+0.50	+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.50	+0.50	+0.50
Central case	4.25	4.50	4.75	4.75	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
50-yr gilt													
Upside risk	+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	4.25	4.50	4.50	4.50	4.75	4.75	4.75	4.75	4.75	5.00	5.00	4.75	4.75
Downside risk		-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25

- The recovery in growth is likely to be slow and uneven, more "W" than "V" shaped. The Bank of England will stick to its lower-for-longer stance on policy rates.
- Gilt yields will remain volatile; yields have been compressed by Quantitative Easing and will rise once QE tapers off and if government debt remains at record high levels.
- Central banks will eventually wind down and exit their emergency liquidity provisions and shrink their balance sheets, but official interest rates in the UK, Eurozone and US will stay low for some while.
- There are significant threats to the forecast from potential downgrades to sovereign ratings and/or political instability.

<u>Assumptions</u>

- The Bank of England has increased **Quantitative Easing** (QE) to £200bn to insure against the downside risks to growth and stimulate the economy.

- The Bank forecasts **GDP** to grow by 4% in 2011 but concedes growth could be impeded by corporate and consumer balance sheet adjustments, restrictions in bank credit and consumers' cautious spending behaviour. This is an optimistic forecast in our view; evidence of recovery is scant with weak real economic data and rising unemployment.

- Looming bank regulation and liquidity and capital requirements will curb banking lending activity. The Bank retains the option to reduce the rate on commercial banks' deposits to encourage them to lend.

- The **employment** outlook remains uncertain. Pay freezes and job cuts will continue into 2010.

- **Inflation** is not an immediate worry. The Bank's forecast is for CPI to rise in the next few months from higher commodity prices and VAT reverting to 17.5%, but is forecast to remain below 2% in the short term, only surpassing the target in 2012. There is a risk that inflation overshoots in 2010 prompting a letter from the Bank's Governor to the Chancellor.

- The **UK fiscal deficit** remains acute. Cuts in public spending and tax increases are now inevitable and more likely to be pushed through in 2010 by a new government with a clear majority.

- The net supply of gilts will rise to unprecedented levels in 2010. Failure to articulate and deliver on an urgent and credible plan to lower government borrowing to sustainable levels over the medium term will be negative for gilts.

- The Federal Reserve Chairman Bernanke's diagnosis of a weak U.S. economy and labour market signal that the Fed's "extended period" of low rates may get even longer. The outlook the Eurozone is more optimistic but the European Central Bank will only increase rates after a durable upturn in growth.

APPENDIX D

Specified and Non Specified Investments

Please note the CLG is in the process of undertaking a review of the Investment Guidance for Local Authorities in England and this section would therefore be subject to review and amendment

Specified Investments identified for use by the Council

Specified Investments will be those that meet the criteria in the CLG Guidance, i.e. the investment

- is sterling denominated
- has a maximum maturity of 1 year
- meets the "high" credit criteria as determined by the Council or is made with the UK government or is made with a local authority in England, Wales and Scotland.
- the making of which is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate).

"Specified" Investments identified for the Council's use are:

- Deposits in the DMO's Debt Management Account Deposit Facility
- Deposits with UK local authorities
- Deposits with banks and building societies
- *Certificates of deposit with banks and building societies
- *Gilts : (bonds issued by the UK government)
- *Bonds issued by multilateral development banks
- AAA-rated Money Market Funds with a Constant Net Asset Value (Constant NAV)
- Other Money Market Funds and Collective Investment Schemes– i.e. credit rated funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.

*1. * Investments in these instruments will be on advice from the Council's treasury advisor.*
2. The use of the above instruments by the Council's fund manager(s) will be by reference to the fund guidelines contained in the agreement between the Council and the individual manager.

For credit rated counterparties, the minimum criteria will be the short-term / long-term ratings assigned by various agencies which may include Moody's Investors Services, Standard & Poor's, Fitch Ratings.

Long-term minimum: A1 (Moody's) or A+ (S&P) or A+(Fitch)
Short-term P-1 (Moody's) or A-1 (S&P) or F1 (Fitch).

The Council will also take into account information on corporate developments of and market sentiment towards investment counterparties.

New specified investments will be made within the following limits:

Instrument	Country	Counterparty	Maximum Limit of Investments %/£m
Term Deposits	UK	DMADF, DMO	No limit
Term	UK	Other UK Local Authorities	No limit

Deposits/Call Accounts			
Term Deposits/Call Accounts	UK	Abbey (This is part of the Santander group which has a combined limit of £6m)	£6,000,000
Term Deposits/Call Accounts	UK	Bank of Scotland/Lloyds	£6,002,000
Term Deposits/Call Accounts	UK	Barclays	£6,000,000
Term Deposits/Call Accounts	UK	Clydesdale (This is part of the NAB group which has a combined limit of £6m)	£6,000,000
Term Deposits/Call Accounts	UK	HSBC	£6,000,000
Term Deposits/Call Accounts	UK	Nationwide	£6,000,000
Term Deposits/Call Accounts	UK	Royal Bank of Scotland	£6,000,000
Term Deposits/Call Accounts	Australia	Australia and NZ Banking Group	£6,000,000
Term Deposits/Call Accounts	Australia	Commonwealth Bank of Australia	£6,000,000
Term Deposits/Call Accounts	Australia	National Australia Bank Ltd	See Clydesdale above
Term Deposits/Call Accounts	Australia	Westpac Banking Corp	£6,000,000
Term Deposits/Call Accounts	Canada	Bank of Montreal	£6,000,000
Term Deposits/Call Accounts	Canada	Bank of Nova Scotia	£6,000,000
Term Deposits/Call Accounts	Canada	Canadian Imperial Bank of Commerce	£6,000,000
Term Deposits/Call Accounts	Canada	Royal Bank of Canada	£6,000,000
Term Deposits/Call Accounts	Canada	Toronto-Dominion Bank	£6,000,000
Term Deposits/Call Accounts	Finland	Nordea Bank Finland	£6,000,000
Term Deposits/Call	France	BNP Paribas	£6,000,000

Accounts			
Term Deposits/Call Accounts	France	Calyon (part of the Credit Agricole Group which has a combined limit of £6m)	£6,000,000
Term Deposits/Call Accounts	France	Credit Agricole SA	See Calyon above
Term Deposits/Call Accounts	Germany	Deutsche Bank AG	£6,000,000
Term Deposits/Call Accounts	Netherlands	Rabobank	£6,000,000
Term Deposits/Call Accounts	Spain	Banco Bilbao Vizcaya Argentaria	£6,000,000
Term Deposits/Call Accounts	Spain	Banco Santander SA	See Abbey above
Term Deposits/Call Accounts	Switzerland	Credit Suisse	£6,000,000
Term Deposits/Call Accounts	US	JP Morgan	£6,000,000
Gilts	UK	DMO	No limit
Bonds	EU	European Investment Bank/Council of Europe	75%
AAA rated Money Market Funds	UK/Ireland/ Luxembourg	CNAV MMFs	25%

NB Any existing deposits outside of the current criteria will be reinvested with the above criteria on maturity.

Non-Specified Investments determined for use by the Council

Having considered the rationale and risk associated with Non-Specified Investments, the following have been determined for the Council's use:

	In-house use	Use by fund managers	Maximum maturity	Max % of portfolio	Capital expenditure?
Deposits with banks and building societies Certificates of deposit with banks and building societies	✓ ✓	 ✓	*5 yrs*	*75%* in aggregate	No
Gilts and bonds Gilts Bonds issued by multilateral development banks Bonds issued by financial institutions guaranteed by the UK government, e.g. GEFCO Sterling denominated bonds by non-UK sovereign governments	✓ (on advice from treasury advisor)	✓	*10 years*	*75%* in aggregate	No
Money Market Funds and Collective Investment Schemes (pooled funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573) but which are not credit rated	✓ (on advice from treasury advisor)	✓	These funds do not have a defined maturity date	*50%*	No
Government guaranteed bonds and debt instruments (e.g. floating rate notes)	✓	✓	*10 years*	*£15m*	Yes

issued by corporate bodies (e.g. govt bonds issued by HBOS / RBS / Nationwide, etc)					
Non-guaranteed bonds and debt instruments (e.g. floating rate notes) issued by corporate bodies	✓	✓	*10 years*	*£5m*	Yes
Collective Investment Schemes (Pooled funds) which do not meet the definition of collective investment schemes in SI 2004 No 534 or SI 2007 No 573	✓ (on advice from treasury advisor)	✓	These funds do not have a defined maturity date	*£5m*	Yes

Investments which constitute capital expenditure will not in aggregate exceed £20m.

1. In determining the period to maturity of an investment, the investment should be regarded as commencing on the date of the commitment of the investment rather than the date on which funds are paid over to the counterparty.
2. The use of the above instruments by the Council's fund manager(s) will be by reference to the fund guidelines contained in the agreement between the Council and the individual manager.

Glossary of Terms

Balances and Reserves	Accumulated sums that are maintained either earmarked for specific future costs or commitments or generally held to meet unforeseen or emergency expenditure.
Bank Rate	The official interest rate set by the Bank of England's Monetary Policy Committee and what is generally termed at the "base rate". This rate is also referred to as the 'repo rate'.
Bond	A certificate of debt issued by a company, government, or other institution. The bond holder receives interest at a rate stated at the time of issue of the bond. The price of a bond may vary during its life.
Capital Expenditure	Expenditure on the acquisition, creation or enhancement of capital assets
Capital Financing Requirement (CFR)	The Council's underlying need to borrow for capital purposes representing the cumulative capital expenditure of the local authority that has not been financed.
Capital growth	Increase in the value of the asset (in the context of a collective investment scheme, it will be the increase in the unit price of the fund)
Capital receipts	Money obtained on the sale of a capital asset.
Credit Rating	Formal opinion by a registered rating agency of a counterparty's future ability to meet its financial liabilities; these are opinions only and not guarantees.
Collective Investment Schemes	Funds in which several investors collectively hold units or shares. The assets in the fund are not held directly by each investor, but as part of a pool (hence these funds are also referred to as 'Pooled Funds'). Unit Trusts and Open-Ended Investment Companies are types of collective investment schemes / pooled funds.
Corporate Bonds	Corporate bonds are bonds issued by companies. The term is often used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies.
Corporate Bond Funds	Collective Investment Schemes investing predominantly in bonds issued by companies and supranational organisations.
CPI	Consumer Price Index. (This measure is used as the Bank of England's inflation target.)
Credit default swaps	Financial instrument for swapping the risk of debt default; the buyer effectively pays a premium against the risk of default.
Diversification / diversified exposure	The spreading of investments among different types of assets or between markets in order to reduce risk.
ECB	European Central Bank

Federal Reserve	The US central bank. (Often referred to as “the Fed”)
Floating Rate Notes	A bond issued by a company where the interest rate paid on the bond changes at set intervals (generally every 3 months). The rate of interest is linked to LIBOR and may therefore increase or decrease at each rate setting
Gilt	Is a fixed rate security issued as debt and repaid at a future date.
IFRS	International Financial Reporting Standards
Income Distribution	The payment made to investors from the income generated by a fund; such a payment can also be referred to as a ‘dividend’
Maturity	The date when an investment or borrowing is repaid
Money Market Funds (MMF)	Pooled funds which invest in a range of short term assets providing high credit quality and high liquidity.
Minimum Revenue Provision	An annual provision that the Authority is statutorily required to set aside and charge to the Revenue Account for the repayment of debt associated with expenditure incurred on capital assets
Non-Specified Investments	Term used in the Communities and Local Government Guidance and Welsh Assembly Guidance for Local Authority Investments. It includes any investment for periods greater than one year or those with bodies that do not have a high credit rating, use of which must be justified.
Pooled funds	See Collective Investment Schemes (above)
Prudential Code	Developed by CIPFA as a professional code of practice to support local authority capital investment planning within a clear, affordable, prudent and sustainable framework and in accordance with good professional practice
Prudential Indicators	Indicators determined by the local authority to define the its capital expenditure and asset management framework. They are designed to support and record local decision making in a manner that is publicly accountable; they are not intended to be comparative performance indicators
PWLB	Public Works Loans Board. It is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. The PWLB's function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments.
Revenue Expenditure	Expenditure to meet the continuing cost of delivery of services including salaries and wages, the purchase of materials and capital financing charges
SI (Statutory Instrumeny)	Is the principal form in which delegated or secondary legislation is made in Great Britain.
SORP	Statement of Recommended Practice for Accounting (Code of Practice on Local Authority Accounting in the United Kingdom).

Specified Investments	Term used in the CLG Guidance and Welsh Assembly Guidance for Local Authority Investments. Investments that offer high security and high liquidity, in sterling and for no more than 1 year. UK government, local authorities and bodies that have a high credit rating.
Supranational Bonds	Instruments issued by supranational organisations created by governments through international treaties (often called multilateral development banks). The bonds carry a AAA rating in their own right. Examples of supranational organisations are the European Investment Bank, the International Bank for Reconstruction and Development.
Supported Capital Expenditure	The financing element of Capital expenditure that is grant funded by Central Government
Treasury Management Code	CIPFA's Code of Practice for Treasury Management in the Public Services
Temporary Borrowing	Borrowing to cover peaks and troughs of cash flow, not to fund spending.
Term Deposits	Deposits of cash with terms attached relating to maturity and rate of return (interest)
Unsupported Capital Expenditure	The financing of Capital expenditure is financed internally through the revenue budget
Yield	The measure of the return on an investment instrument