St Edmundsbury
BOROUGH COUNCIL

Z517

Cabinet
11 February 2009

Treasury Management Performance and Annual Treasury Management and Investment Strategy 2009/2010

1. Summary and Reasons for Recommendations

1.1 The Council's Treasury Management activities generate a substantial amount of income and therefore warrant regular Member consideration. The purpose of this report is to:-

(a) provide an update on Treasury Management activity and performance for the period 1 April to 31 December 2008, and

(b) seek Cabinet and Council approval for the Annual Treasury Management and Investment Strategy Statements for 2009/2010 and Prudential Indicators as detailed in Appendix 1 to this report.

1.2 The budget for investment income in 2008/2009 is £2,102,000, equivalent to £55.92 for each Council Tax Band D property. At the end of December 2008 interest earned amounted to £2,517,300 against the budget for the period of £1,679,750, a surplus of £837,550. The over achievement of interest on investments during this period was due to higher than expected interest rates and to slippage on the capital programme. The target investment rate for the year is 4.75%. In the nine month period covered by this report, the average rate of interest achieved was 5.43%.

1.3 The proposed Treasury Management and Investment Strategy Statements for 2009/2010, attached at Appendix 1 to this report, set out the Council's strategies for managing investments. These strategies give priority to the security and liquidity of investments whilst at the same time seeking to optimise financial returns. The recommendations arising from the Strategy Statements are designed to give maximum flexibility in terms of the usage of fixed and variable rate investments and allow for the balancing of certainty of income arising from longer term investments with the need to retain a core balance to enable day-to-day cash flow management and which can be easily liquidated should the need arise.

1.4 It is estimated that in 2009/2010 Treasury Management activity will generate income of £751,000 (which is equivalent to £19.87 for each Council Tax Band D property). This represents an average target investment rate for the year of 2.2% and reflects the very significant reduction in interest rate projections for the year. Appendix 2 provides a summary of the national and international forecasts provided by the Council's treasury management advisors (Sector Treasury Services Ltd) which support these estimates. In addition, it is estimated that the Council's non operational property and assets portfolio will generate income of £2,641,450 during the year (which is equivalent to £69.90 for each Council Tax Band D property).

2. Recommendations

2.1 Information on the performance of the Treasury Management function for the period 1 April to 31 December 2008 contained within this report be noted.

2.2 Subject to approval by full Council, it is recommended that:-

(a) the Annual Treasury Management Strategy Statement and Annual Investment Strategy for 2009/2010, together with the Prudential Indicators as detailed in Appendix 1 to Report Z517, be approved;

(b) the upper limit on fixed and variable rate exposures be set at 95% and 40% respectively of the Council's total investments; and

(c) the upper limit for principal sums invested for more than 364 days be set at £20million.

3. Corporate Objectives

3.1 The recommendations meet the following, as contained within the Corporate Plan:-

(a) Corporate Priority: *'To raise corporate standards and efficiency'*; and
(b) Cabinet Commitments: *'Improving Efficiency and Value for Money'.*

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4. Key Issues

4.1 Treasury Management Performance: 1 April to 31 December 2008

4.1.1 The Council's Treasury Management activities generate a substantial amount of income and therefore warrant regular Member consideration. The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management, adopted by the Council in March 2002, requires that the Cabinet receives regular progress reports on treasury management activity.

4.1.2 **Investment Position** The total amount invested at 1 April 2008 was £56.2m, at 30 September 2008 was £61.35m, and at 31 December 2008 was £55.55m. It should be noted that the Council has never held funds with any Icelandic banks and so has not been affected by the recent collapse of that country's banking system. The Council's treasury management advisors, Sector Treasury Services Limited, are continuing to provide on-going advice on the creditworthiness of individual financial institutions based upon the latest assessments provided by the Fitch and Moody credit rating agencies. In addition, the Council's investment strategy seeks to minimise the risks associated with fluctuations in interest rates and the potential collapse of individual financial institutions, by spreading funds across a range of organisations for varying durations at fixed rates of interest.

4.1.3 The budget for investment income for the 2008/2009 financial year is £2,102,000, equivalent to £55.92 for each Council Tax Band D property. At the end of December 2008 interest earned amounted to £2,517,300 against the budget for the period of £1,679,750, a surplus of £837,550. The over achievement of interest on investments during this period was due to higher than expected interest rates (£240,450) and to slippage on the capital programme and other cash flow advantages (£597,100). The target investment rate for the year is 4.75%. In the nine month period covered by this report, the average rate of interest achieved has been 5.43%. Furthermore, as at 31 December 2008 only £14,190,000 had been spent out of the full year's original capital programme budget of £29,468,000.

4.1.4 **Interest Rate Fluctuations** The target investment rate of 4.75% was set in February 2008 as part of the budget process. This rate was set on the basis of interest projections provided by the Council's external treasury advisors, Sector Treasury Services Limited. The base rate at 1 April 2008 was 5.25% which fell to 5.00% on 10 April 2008. On 8 October 2008 the Bank of England's Monetary Policy Committee (MPC) cut rates by 0.5% (to 4.5%) as part of a co-ordinated rate cut by several of the world's central banks, including the US Federal Reserve and the European Central Bank. This move was taken to help alleviate some of the problems associated with the credit crisis and to help stimulate economic growth amid concerns of a global recession. Further cuts in interest rates followed on 6 November 2008 (1.5% cut to 3%) 4 December 2008 (1% cut to 2%) and 8 January 2009 (0.5% cut to 1.5%).

4.1.5 Many financial analysts are now predicting further falls in the bank base rate over the forthcoming months. Sector's latest view is that rates may fall to 0.5% in the last quarter of 2008/2009, with rates not rising much above this level until the Summer of 2010. As many of our investments are for fixed durations and at fixed rates, the full impact of rate cuts will not be felt until the 2009/2010 financial year. In view of latest projections of spending on capital projects and receipts from the sale of assets, it is expected that the current level of budget surplus on investment returns will be maintained during this financial year.

4.2 Annual Treasury Management and Investment Strategy: 2009/2010

4.2.1 The CIPFA Code of Practice requires that a treasury management strategy is approved by the Council prior to the beginning of the financial year to which it relates. The proposed Treasury Management and Investment Strategy Statements for 2009/2010, attached at Appendix 1 to this report, meets the requirements of the CIPFA code together with the Department for Communities and Local Government (DCLG) Guidance on Local Government Investments and the statutory requirements of the Local Government Act 2003 (relating to the need to set Prudential Indicators to ensure that the Council's capital investment plans are affordable, prudent and sustainable). The Strategy Statements seek to optimise financial returns on investments whilst also giving priority to the security and liquidity of funds. They also seek to give maximum flexibility in terms of the usage of fixed and variable rate investments and allow for the balancing of certainty of income arising from fixed term investments with the need to retain a core balance that can be easily liquidated should the need arise.

4.2.2 The Strategy confirms the Council's debt free status and indicates that there are no plans to borrow monies for capital purposes in the foreseeable future. Within this overall Strategy the Chief Finance Officer may approve short term borrowings (less than 12 month in duration) to provide for day to day cash flow management. This does not affect the Council's debt free status.

4.2.3 In response to the credit crisis new sections have been included within the Strategy Statement to cover the Council's approach to UK nationalised banks and banks that are being supported by the Government's recent bail-out package. In response to the specific problems highlighted by the Icelandic banking crisis, it is also proposed that where the Council is considering placing investments with financial institutions outside the UK, existing credit ratings (based on the Fitch and Moody ratings) are enhanced by the inclusion of sovereign ratings which are designed to reflect the ability of individual countries to provide support should their financial institutions fail. In this respect it is proposed that the Council should only place investments in countries with a minimum AAA sovereign rating.

4.2.4 It is estimated that in 2009/2010 Treasury Management activity will generate income of £751,000 (which is equivalent to £19.87 for each Council Tax Band D property) This represents an average target investment rate for the year of 2.2%. The considerable reduction in investment income compared to the 2008/2009 estimate (ie., investment income of £2,102,000, equivalent to £55.92 for each Council Tax Band D property) takes into account the substantial fall in projected interest rates, the maturity dates for the Council's current fixed term investments, and the reduction in Council balances arising from the impact of the effect of the estimated capital expenditure and the reducing asset disposals programmes. Appendix 2 provides a summary of the national and international forecasts provided by the Council's treasury management advisors (Sector) which support the underlying interest rate projections used in the preparation of these estimates.

4.3 Investment Portfolio

4.3.1 The Council also owns a portfolio of non-operational property and assets which are managed on firm estates management and asset management principles. Its capital value as at 31 March 2008 was £26,896,000. It is estimated that in 2009/2010 this will generate income of £2,641,450 equivalent to £69.90 for each Council Tax Band D property.

5. Other Options considered

5.1 In the past the Council has employed fund managers to look after its major investments, but returns were consistently less than those achieved through the in-house management of funds.

6. Community impact *(including Section 17 of the Crime and Disorder Act 1998 and diversity issues)*

6.1 **General** - The level of interest earned on investments reduces the demand on the Council Tax payer to fund the cost of service provision.

6.2 **Diversity -** All Council Tax payers in the St Edmundsbury area will benefit from the interest achieved on investments.

7. Consultation

7.1 Portfolio Holder for Resources and Efficiency and the Corporate Management Team.

8. Resource implications *(including asset management implications)*

8.1 It is estimated that in 2009/2010 Treasury Management activity will generate income of £751,000 (which is equivalent to £19.87 for each Council Tax Band D property) and the Council's non operational property and assets portfolio will generate income of £2,641,450 (which is equivalent to £69.90 for each Council Tax Band D property).

9. Risk Assessment *(potential hazards or opportunities affecting corporate, service or project objectives)*

9.1 In order to mitigate risk, the investment priorities are the security of the Council's capital and the liquidity of its investments. Within these priorities the aim is to achieve the optimum return on investments. Investment activities are carried out in accordance with the approved Annual Strategy and comply with the CIPFA Code of Practice. The treasury management function is supported by external advisors (Sector) who provide on-going advice on investment strategies and policies together with daily updates on the credit rating of individual banks and building societies.

9.2 The Council has a high level of capital receipts. The interest obtained on the investment of these receipts is significant and helps to support the annual level of Council Tax. As fluctuations in interest rates and levels of capital expenditure and receipts can impact considerably on the Council's budget the Council has established an Interest Equalisation Reserve which can be used to help smooth out year-on-year variances in investment returns. In addition, the portfolio of investments includes loans for varying periods of duration of up to five years at fixed rates of interest and these give some certainty of return for a proportion of the investments.

Risk area	Inherent level of Risk (before controls)	Controls	Residual Risk (after controls)
	High/Medium/Low		High/Medium/Low
Economic (fluctuations in interest rates)	High	Spread of investments for periods of up to three years	High
Bank / building society failure resulting in loss of Council funds.	High	Use of Sector advice on credit ratings (based on Fitch and Moody ratings) and restrictions in use of non-rated building societies. Use of sovereign ratings to assess ability of Countries to support failing banks.	Medium
Fluctuations in capital expenditure and asset disposal programmes having significant impact on target investment returns	Medium	Budget monitoring Interest Equalisation Reserve	Medium

10. Legal or policy implications

10.1 Consideration of the report complies with Council policy and the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice.

Wards affected	All	**Portfolio Holder**	Resources and Efficiency
Background Papers		**Subject Area** Finance	

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ANNUAL TREASURY MANAGEMENT AND INVESTMENT STRATEGY STATEMENTS 2009/2010

1. Introduction

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

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

1.3 The suggested strategy for 2009/10 in respect of the following aspects of the treasury management function is based upon the Chief Finance Officer's views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor Sector Treasury Services Limited. The strategy covers:

- treasury limits in force which will limit the treasury risk and activities of the Council
- prudential indicators
- the current treasury position
- prospects for interest rates
- the borrowing strategy
- the investment strategy.

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

1. increases in interest charges caused by increased borrowing to finance additional capital expenditure, and

2. any increases in running costs from new capital projects are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

2. Treasury Limits for 2009/10 to 2011/12

2.1 It is a statutory duty under S.3 of the Local Government Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and Wales the Authorised Limit represents the legislative limit specified in section 3 of the Local Government Act 2003.

2.2 The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax is 'acceptable'.

2.3 The Council is debt free and there are no plans to borrow monies in the foreseeable future. Within this overall strategy the Chief Finance Officer may approve short term borrowings

(ie less than 12 months in duration) to provide for day to day cash flow management requirements. This does not affect the Council's debt free strategy or status.

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

3.1 The Prudential Code requires the Council to set Prudential Indicators on External Debt. As indicated above it is not anticipated that the Council will undertake any borrowing with the result that the required indicators for "Authorised Limit", "Operational Boundary" and the "Maturity Structure of Borrowing" will all be zero.

3.2 The Council must also consider risk associated with interest rate exposures and set upper limits on the level of investments for both fixed rate and variable rate investments, together with an upper limit on the level of investments with maturity of more than 364 days. The majority of in-house investments are fixed rate. To provide maximum flexibility it is proposed that the upper limit on fixed rate investments be set at 95% of the amount available for investment. Similarly in order to provide maximum flexibility, it is suggested that the upper limit on variable rate investments be set at 40% of total investments, so that at all times the Council has at least 55% in fixed rate investments to provide stability.

3.3 With regard to sums invested for more than 364 days, there is a need to balance certainty of income with flexibility to take advantage of upward movements in interest rates, whilst at the same time retaining a core element of investments that can be easily liquidated should the need arise. It is therefore suggested that the upper limit on investments for more than 364 days be set at £20 million. This figure allows the in-house treasury management team to invest up to £20 million for periods of 1-5 years to provide increased certainty of income.

3.4 As a result the following prudential indicators are relevant for the purposes of setting an integrated treasury management strategy.

PRUDENTIAL INDICATOR	**2007/08**	**2008/09**	**2009/10**	**2010/11**	**2011/12**
TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
	actual	**probable outturn**	**estimate**	**estimate**	**estimate**
Authorised limit for external debt -					
Borrowing	£0.00	£0.00	£0.00	£0.00	£0.00
other long term liabilities	£0.00	£0.00	£0.00	£0.00	£0.00
TOTAL	£0.00	£0.00	£0.00	£0.00	£0.00
Operational boundary for external debt -					
Borrowing	£0.00	£0.00	£0.00	£0.00	£0.00
other long term liabilities	£0.00	£0.00	£0.00	£0.00	£0.00
TOTAL	£0.00	£0.00	£0.00	£0.00	£0.00
Upper limit for fixed interest rate exposure					
expressed as a % of total investments			95%	95%	95%
Upper limit for variable rate exposure					
expressed as a % of total investments			40%	40%	40%
Upper limit for total principal sums invested for over 364 days (per maturity date)			£20m	£20m	£20m

3.5 The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The Code was adopted by the full Council on 21 March 2002.

4. Current Portfolio Position

4.1 The Council's treasury portfolio position at 31 December 2008 was:

Investments	Amount
Total Investments (in-house)	£55.55m
Average rate of return (April to December 2008)	5.43%
Debt	£nil

5. Prospects for Interest Rates

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

5.2 **Sector's Views:**

5.2.1 **Interest rate forecast**

	Q1 2009	***Q2 2009***	***Q3 2009***	***Q4 2009***	***Q1 2010***	***Q2 2010***	***Q3 2010***	***Q4 2010***
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%
5yr PWLB	2.50%	2.25%	2.15%	2.15%	2.15%	2.45%	2.80%	3.15%
10yr PWLB	3.10%	2.75%	2.55%	2.55%	2.55%	2.85%	3.25%	3.65%
25yr PWLB	4.00%	3.95%	3.95%	3.95%	4.00%	4.15%	4.35%	4.45%
50yr PWLB	3.85%	3.80%	3.80%	3.80%	3.85%	3.90%	4.00%	4.25%

The Public Works Loan Board (PWLB) is a UK statutory body linked to HM Treasury whose function is to lend direct to local authorities and other public sectors bodies.

Sector's current interest rate view is that Bank Rates will fall from current levels because of the intensifying global recession starting 2009 at 1.5% and falling to 0.5% in Q1 2009 where they are expected to remain until Q2 2010 when they are predicted to start rising. There is downside risk to these forecasts if the recession proves to be deeper and more prolonged than currently expected

6. Borrowing Strategy

6.1 It is anticipated that there will be no capital borrowings required during 2009/10.

7. Annual Investment Strategy

7.1 Investment Policy

7.1.1 The Council will have regard to the then Office of the Deputy Prime Minister's (ODPM's) Guidance on Local Government Investments ("the Guidance") issued in March 2004 and CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

7.1.2 The Council's investment priorities are the security of capital and the liquidity of its investments. The aim will also be to achieve the optimum return on investments commensurate with proper levels of security and liquidity.

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

7.1.4 Investment instruments identified for use in the financial year are at 7.1.7 and 7.1.8 below and counterparty limits will be as set through the Council's Treasury Management Practices.

7.1.5 So far as credit criteria are concerned the credit worthiness service provided by Sector Treasury Services and which is based upon Fitch ratings is used. In this respect Sector alert the Council to changes in Fitch ratings.

The credit worthiness criteria are based upon the following components:

i) Long Term and Short Term Ratings: The long term (Fitch use AAA through to C ratings) and short term ratings (Fitch use F1+ to C ratings) are used to express an opinion on an institutions capacity to service and repay punctually its debt obligations.

   - A short term rating covers obligations which have an original maturity not exceeding one year, and places greater emphasis on the liquidity necessary to meet financial commitments.

   - Longer term ratings generally cover maturities of up to five years and the emphasis shifts to the assessment of the ongoing stability of the institutions prospective financial conditions.

ii) Individual Ratings: Fitch's individual ratings are a measure of an institution's intrinsic safety and soundness on a stand alone basis. These ratings are divorced from considerations of external support from either parent or the government and are therefore useful indicators of credit quality.

iii) Support Ratings: Fitch is the only agency which explicitly states its view of the likely presence of a lender of last resort, with the willingness and resources to aid failing financial institutions. The ratings are on a continuous sliding scale from 1, the top quality and certain of support, down to 5, the weakest and least certain level of support.

7.1.6 Where a counterparty does not have a Fitch rating, the equivalent Moody's rating will be used. If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

7.1.7 **Specified Investments**: (All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum 'high' rating criteria where applicable).

	Minimum 'High' Credit Criteria
Debt Management Agency Deposit Facility	--
Term deposits – local authorities	--
Term deposits – banks and building societies (see separate table for credit criteria re build socs)	Short-term F1, Long-term A, Individual C, Support 3
Certificates of deposits issued by banks and building societies	Short-term F1, Long-term A, Individual C, Support 2
Bond issued by multilateral development banks	AAA
Bonds issued by a financial institution which is guaranteed by the UK government	AAA

7.1.8 **Non-Specified Investments**: (All such investments will be sterling denominated, with maturities over 1 year, meeting the minimum 'high' rating criteria where applicable)

A maximum of 70% will be held in aggregate in non-specified investments

	Minimum Credit Criteria	**Use**	**Max % of total investments**	**Max. maturity period**
Term deposits – other LAs with maturities >1yr	-	In-house	50	5 years
Term deposits – banks and building societies (see separate table for credit criteria re build socs) with maturities >1yr	Short-term F1+ Long-term AA- Individual B/C Support 2	In-house	85	5 years
Bonds issued by multilateral development banks with maturities >1yr	AAA	In-house	25	5 years
Bonds issued by a financial institution which is guaranteed by the UK government with maturities >1yr	AAA	In-house	25	5 years

7.1.9 **Building Societies** - so far as making term deposits with building societies are concerned the following criteria will be used:

Minimum Credit Criteria	**Maximum Investment (£)**	**Maximum Period**
Long-term AA-	£10m	5 years
Long-term A	£5m	5 years
Unrated but with £1,000m in assets.	£5m	3 years

7.1.10 Whilst the above lists of investment instruments gives maximum flexibility, in practice the in house team only use the Debt Management facility, and term deposits with other local authorities, banks and building societies.

Developments in response to the Credit Crunch Crisis –

7.1.11 The following criteria have been introduced to respond to the specific issues raised by the current credit crunch crisis:

7.1.12 **Nationalised Banks** - Nationalised banks (eg Northern Rock) in the UK have credit ratings which do not conform to the credit criteria usually used by local authorities to identify banks which are of high credit worthiness. In particular, as they no longer are separate institutions in their own right, it is impossible for Fitch to assign them an individual rating for their stand alone financial strength. Accordingly, they have assigned an F rating which means that at a historical point of time, this bank failed and is now owned by the Government. However, these institutions are now recipients of an F1+ short term rating as they effectively take on the creditworthiness of the Government itself i.e. deposits made with them are effectively being made to the Government. They also have a support rating of 1; in other words, on both counts, they have the highest ratings possible (i.e. maximum investment of £10m up to 5 years in duration).

7.1.13 **Banks Supported by the UK Government's banking system support package -** A number of UK banks are receiving direct financial from the Government (e.g. Abbey, Barclays, HBOS, Lloyds TSB, HSBC, Nationwide, RBS and Standard Chartered). It is noted however that the UK Government has not given a blanket guarantee on all deposits but has underlined its determination to ensure the security of the UK banking system by supporting these banks. Whilst this provides a reasonable degree of assurance the Council will continue to rely on the formal credit ratings for these organisations when determining where to place new investments.

7.1.14 **Sovereign Ratings** - In response to the specific problems highlighted by the Icelandic banking crisis, in addition to reliance on the individual counterparty's credit ratings, where the Council is considering placing investments with financial institutions outside the UK, consideration will also be given to the sovereign rating of the host Countries. These ratings are designed to reflect the ability of individual countries to provide support to their failing financial institutions. In this respect the Council should only place investments in countries with a minimum AAA sovereign rating.

7.2 Investment Strategy

7.2.1 All the Council's investments are currently managed in house**.** The majority of the Council's investments are placed through the money markets with banks and building societies for fixed periods of time (up to five years duration) and at fixed rates of interest. The Council also retains a core balance within liquidity accounts which takes account of the Council's proposed capital expenditure and the need to retain flexibility for cash flow purposes. The minimum amount which is to be held during the financial year in investments other than long term investments should be £20 million. Investments will accordingly be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

7.2.2 So far as fixed term investments are concerned, as at the time of this report, the Council already has a number of investments that span the financial year including longer dated deposits and callable deposits. These include callable deposits of £10m which could run to March 2011.

7.2.3 Bank Rate started on a downward trend from 5.75% in December 2007 with further cuts of 0.5% in February and April 2008, then 0.5% in October, 1.5% in November, 1% in December and a further 0.5% in January 2009 (bringing the base rate down to 1.5%). Further cuts of 1% are expected during Q1 2009. It is then expected to stabilise at 0.50% until starting to rise gradually with the first increase in Q2 2010 and then to be back up to 4.00% during Q1 2012. Sector is advising clients to avoid locking into longer term deals while investment rates are down at historically low levels.

7.2.4 Sector is advising clients for 2009/10 to budget for an investment return of 1.50% on investments placed during 2009/10. Based on this projection, and taking into account the returns being achieved on the Council's current portfolio of fixed term investments, the average target rate investment return for 2009/2010 is 2.2%. For 2010/11 Sector project an average investment rate of 1.94% rising to 3.88% during 2011/12. These rates are used to help inform fixed term investment decisions.

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

7.2.6 Taking into account the projected value of the investment portfolio after cash flow movements during 2009/10, it is estimated that investments in 2009/10 will generate income of £703,000. This is equivalent to £18.60 for each Council Tax Band D property.

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

8 Investment Portfolio

8.1 The Council also owns a non-operational property portfolio which is managed on robust estate management and asset management principles. Its capital value, as in the balance sheet at 31 March 2008 was £26,896,000. It is estimated that in 2009/10 this will generate income of £2,641,450 million equivalent to £69.90 for each Council Tax Band D property.

9 Minimum Revenue Provision Policy Statement

9.1 Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. Capital expenditure can be financed though the Council's capital reserves (accumulated from capital receipts), revenue contributions (including use of revenue reserves) or external debt. Where capital expenditure is financed by external debt it would be impractical to charge the entirety of such expenditure to revenue in the year in which it was incurred and such expenditure is spread over several years to match the expected useful life of the asset. The manner of spreading these costs is through an annual Minimum Revenue Provision, which was previously determined under Regulation, and will in future be determined under Guidance.

9.2 Statutory Instrument 2008 no. 414 s4 lays down that:

"A local authority shall determine for the current financial year an amount of minimum revenue provision that it considers to be prudent."

The above is a substitution for the previous requirement to comply with regulation 28 in S.I. 2003 no. 3146, (as amended)

9.3 There is no requirement to charge MRP where the Council's Capital Financing Requirement (the underlying need for the Council to borrow) is nil or negative at the end of the preceding financial year. As the Council is currently debt free there is therefore no requirement to charge MRP. Should the Council's debt free status change the Council will implement the Minimum Revenue Provision (MRP) in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

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APPENDIX 2

ECONOMIC BACKGROUND – NATIONAL AND INTERNATIONAL FORECASTS

1. Introduction

This appendix provides a summary of the international and national economic forecasts (including details of comparative interest rates projections) provided by the Council's treasury management advisors, Sector Treasury Services Ltd. This information is provided in support of Sector's projections on interest rates which are used by the Council to determine the annual target rate of investment return which is used to estimate investment returns in 2009/120 and future years.

2. Sector's National and International Forecasts

The sub prime crisis of early 2008 was supplanted by the banking crisis of autumn 2008. The world banking system came near to collapse and governments around the world were forced to recapitalise and rescue their major banks. The resulting dearth of lending from banks anxious to preserve capital led to economic forecasts being sharply reduced and recession priced into markets. This in turn led to sharp falls in oil and other commodity prices with the result that inflation, which in the UK was running at over 5%, became yesterday's story and recession fears drove interest rate sentiment and policy. A co-ordinated global interest rate cut of 0.5% took place on 8th October 2008. Forecasts in the UK were for further sharp cuts in interest rates as recession hove into view.

3. International

- Early in 2008 the US economy was being badly affected by the housing market slump. Interest rates were at 2% and inflation was being dragged higher by the inexorable rise in commodity prices. The European Central Bank (ECB) was very concerned about rising inflation and less about the state of the economy.
- The second quarter of 2008/9 was torn between inflation worries on the one hand, with oil rising towards $150 per barrel, and the deteriorating economic outlook on the other.
- In the second and third quarters of the year the financial crisis erupted and escalated as the world became aware of the extent of the sub-prime fiasco and the impact it was having on institutions that had invested in these issues.
- In September Fannie Mae/Freddie Mac (the mortgage banks) and AIG, the insurance giant, had to be bailed out by the US Federal Government.
- Then in mid September, Lehman Bros., the investment bank, was allowed to fail. This triggered a domino effect with other banks and financial institutions having to be rescued or supported by governments around the world.
- After the collapse into receivership of the Icelandic banks in early October, other countries then started to feel the strain and a number had to approach the International Monetary Fund (IMF) for support.
- Eventually even the Asian 'Tiger' economies were affected, including India and China, and it became clear that the crisis had become a global one and no country was insulated from it.
- The financial crisis had therefore precipitated an economic crisis and there was a co-ordinated global interest rate cut with the US Federal reserve (Fed), ECB and the UK's Monetary Policy Committee (MPC) all cutting rates by 0.5% on 8 October. The Fed subsequently cut rates again by 0.5% to 1% on 29th October and again on 16 December to a band of 0.0% to 0.25% in an attempt to stave off the oncoming recession. Inflation was yesterday's problem.
- The ECB reduced rates again on 6 November by 0.5% and by its biggest ever cut of 0.75% on 4 December to reach 2.5%.

4. United Kingdom

- Gross Domestic Product (GDP): growth was already slowing in 2008 from 2007 before the full impact of the credit crunch was felt. Earlier in 2008 GDP was 2.3% whereas in the autumn the figure fell back to -0.3% and was then expected to continue to be negative going into 2009.
- Wage inflation remained relatively subdued as the Government kept a firm lid on public sector pay. Private sector wage growth was kept in check by the slowing economy.
- Growth slowed across the economy and unemployment rose throughout the year with forecasts of 2 million unemployed by the end of the financial year and continuing to increase thereafter through 2010.
- Notwithstanding the pressures on household finances consumer spending still continued at a reasonable level although the trend was slowing as the year progressed.
- Bank lending came to a virtual standstill in the autumn as the credit crunch tightened its grip and various banks internationally had to be rescued, or supported, by their governments.
- The Government and Bank of England supplied massive amounts of liquidity to the banking market in an attempt to reignite longer interbank lending.
- The Government took action in September to either supply finance itself to recapitalise some of the major clearing banks or to require the others to strengthen their capital ratios by their own capital raising efforts. This was so that these banks would be seen to have sufficient reserves to last through the coming recession with its inevitable increase in bad loans etc.
- The housing market also came to a virtual standstill as lenders demanded larger deposits and higher fees. House sales and prices both dropped sharply.
- Government finances deteriorated as income from taxation dropped as the economy slowed and the cost of the bailout of the banks was added to the deficit.
- U.K. equity prices declined sharply in the 3rd and 4th quarters as the impending recession was priced into the markets. Prices hit five year lows and volatility was extremely high.
- The story of 2008 has been the credit crunch, the banking crisis and the change in economic outlook from slow growth to outright recession. After the initial concerns about the impact of the credit crunch in the earlier part of 2008 it appeared as though the storm had been weathered. The MPC had been very concerned about Consumer Price Index (CPI) inflation, which had been rising sharply on the back of higher commodity and food prices. Bank Rate reached a peak of 5.75% in July 2007 after which cuts of 0.25% occurred in December 2007 and February and April 2008 before the major cuts in the autumn. The economic data had been indicating a slowing economy for some while but it was not sufficiently weak to force the MPC into another cut. It was the strength of the banking crisis, pre-empted by the collapse of Lehmans in New York that eventually drove the MPC to cut interest rates by 0.5% on October 8th in concert with the Fed, the ECB and other central banks. It was then appreciated that the economic downturn would be much more severe than previously thought and interest rates were subsequently slashed by 1.5% on 6 November, 1% on 4 December and 0.5% bps on 8 January 2009.
- The LIBOR spread over Bank Rate has also been a feature, and a concern, of 2008/9. Because of the credit fears and the reluctance of lenders to place cash for long periods 3 month LIBOR (this is the London Inter Bank Offer Rate – the rate at which banks will lend to one another) has been substantially higher than Bank Rate. This has meant that the MPC's power over monetary policy has been eroded by the widening of this spread between LIBOR and Bank Rate and it has therefore had a limited ability to bring relief to hard pressed borrowers through lower interest rates. However, the power of the Government over the semi nationalised clearing banks had considerable impact in enforcing pro rata reductions to the 1.5% Bank Rate cut in November on some borrowing rates.
- The Government has abandoned its 'golden rule'. The pre Budget Report on 14 November revealed the Government's plans for a huge increase in Government borrowing over coming years as a result of falling tax revenues and also due to tax cuts and increases in

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

5. Interest Rate Forecasts

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

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

Individual Forecasts

Sector interest rate forecast – 6 December 2008

	Q1 2009	*Q2 2009*	*Q3 2009*	*Q4 2009*	*Q1 2010*	*Q2 2010*	*Q3 2010*	*Q4 2010*
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%
5yr PWLB	2.50%	2.25%	2.15%	2.15%	2.15%	2.45%	2.80%	3.15%
10yr PWLB	3.10%	2.75%	2.55%	2.55%	2.55%	2.85%	3.25%	3.65%
25yr PWLB	4.00%	3.95%	3.95%	3.95%	4.00%	4.15%	4.35%	4.45%
50yr PWLB	3.85%	3.80%	3.80%	3.80%	3.85%	3.90%	4.00%	4.25%

Capital Economics interest rate forecast – 12 January 2009

	Q1 2009	*Q2 2009*	*Q3 2009*	*Q4 2009*	*Q1 2010*	*Q2 2010*	*Q3 2010*	*Q4 2010*
Bank rate	0.50%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
5yr PWLB	1.65%	1.45%	1.45%	1.45%	1.45%	1.45%	1.45%	1.45%
10yr PWLB	2.65%	2.15%	2.15%	2.15%	2.15%	2.15%	2.15%	2.15%
25yr PWLB	4.15%	4.00%	3.80%	3.65%	3.65%	3.65%	3.65%	3.65%
50yr PWLB	4.05%	3.95%	3.85%	3.75%	3.75%	3.75%	3.75%	3.75%

UBS Economics interest rate forecast – 12 December 2008

	Q1 2009	*Q2 2009*	*Q3 2009*	*Q4 2009*
Bank rate	0.50%	0.50%	0.50%	0.75%
10yr PWLB	3.75%	4.15%	4.35%	4.65%
25yr PWLB	4.25%	4.55%	4.85%	5.05%
50yr PWLB	4.30%	4.65%	5.00%	5.25%

Survey of Economic Forecasts: HM Treasury – December 2008 summary of forecasts of 23 City and 12 academic analysts for Q4 2008 and 2009. (2010 – 2012 are based on 21 forecasts in the last quarterly forecast – November 2008).

Average of Independent Forecasters:

	Bank rate actual	*Q4 2008*	*Q4 2009*	*Average 2010*	*Average 2011*	*Average 2012*
Median	2.00%	2.00%	1.00%	3.11%	3.97%	4.49%
Highest	2.00%	4.50%	4.00%	4.70%	5.00%	5.25%
Lowest	2.00%	2.00%	0.50%	1.00%	2.25%	3.00%

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