Cabinet

13th February, 2008

Capital Programme 2008/2009 including Prudential Indicators and Treasury Management Strategy

Report of the Chief Executive and City Treasurer

1. Purpose of Report:

1.1 To update Members of the level of capital resources and commitments for the forthcoming financial year and seek a recommendation to Council to the overall Capital Programme 2008/2009, the Prudential Indicators and the Treasury Management Strategy for 2008/2009.

2. Description of Decision:

2.1 Cabinet is requested to:

- recommend to Council approval of:
    - the proposed Capital Programme for 2008/2009;
    - the prudential indicators;
    - the Annual Minimum Revenue Provision statement;
    - the Annual Treasury Management Strategy including specifically the Annual Borrowing and Investment Strategies.
- note the Treasury Management Policy.

3. Capital Programme 2008/2009

3.1 As reported to Cabinet in January 2008 and in accordance with the Council's Capital Strategy, resources for the main programme areas of Education, Social Services, Highways and Housing have been allocated on the basis of their Supported Capital Expenditure (SCE (R)) approvals and other service specific resources. In addition, capital receipts arising from the planned sale of assets specific to Children's Services and Adult Services have been earmarked.

3.2 Any further SCE (R) or grant approvals which are received will be reported to Cabinet as part of the regular capital programme reviews during the year.

3.3 In preparing the capital programme, £2.0 million is forecast to fund the 'Other Services' capital programme from additional capital receipts expected to be received in 2008/2009. It is anticipated that there will be delays in the realisation of Children's Services capital receipts in 2007/2008. It is estimated therefore that temporary funding of £5.3 million will need to be provided from the Strategic Investment Reserve. The temporary funding will be repaid once expected receipts are realised.

3.4 Since the January 2008 Cabinet meeting, consultation with the appropriate Cabinet Portfolio Holders has been undertaken on the proposals to utilise the resources available for new starts. In considering proposals for new starts regard has been had to the Council's Capital Strategy approved by Cabinet on 13th September 2006.

3.5 The recommended Capital Programme set out in the Corporate Improvement Plan includes proposed new starts for Children's Services, Adult Services, Housing, and Highways. Proposed new starts for the Environmental Protective and Cultural Services (Other Services) Block are attached at Appendix A.

3.6 In accordance with the Council's Constitution, prior to commencement of projects, details of all new schemes with an estimated cost in excess of £250,000 will be reported for approval to Cabinet utilising the capital investment appraisal documentation which outlines the detail of the scheme, and outputs and outcomes expected together with funding sources and consequential revenue implications.

4. Prudential Framework for Local Authority Capital Expenditure

4.1 One of the principal features of the Local Government Act 2003 was to provide the primary legislative framework to introduce a prudential regime for the control of Local Authority capital expenditure. The regime relies upon both secondary legislation in the form of regulations, and a prudential code issued and maintained by the Chartered Institute of Public Finance and Accountancy (CIPFA).

4.2 Under the prudential framework local authorities are free to borrow without specific government consent if they can afford to service the debt without extra government support. The basic principle is that authorities will be free to invest as long as their capital spending plans are affordable, sustainable and prudent. As a control mechanism to ensure this occurs, all authorities must follow the prudential code published by CIPFA. This involves setting various prudential limits and indicators that must be approved by the Council before the start of the relevant financial year as part of their budget setting process. The prudential indicators have been prepared and all matters specified in the code have been taken into account. Regular monitoring will take place during the year and reports made to Cabinet on the indicators as part of the quarterly capital review reports where appropriate.

4.3 Government provide support for capital expenditure in one of two ways:

- Supported Capital Expenditure (Revenue);
- Supported Capital Expenditure (Capital).

The Supported Capital Expenditure (Revenue) (SCE (R)) is in effect revenue support through the Revenue Support Grant System to finance borrowing. The Supported Capital Expenditure (Capital) (SCE (C)) is a capital grant given by government.

Under the Prudential Framework, the facility to undertake what is known as ‘unsupported borrowing’ is available. However, in deciding upon whether to undertake unsupported borrowing regard is required to be had to:

- the prudential indicators which are designed to assess whether capital investment needs are affordable, sustainable and prudent;
- the effect on the revenue budget of any additional costs incurred.

5. The Annual Minimum Revenue Provision Statement

5.1 The Secretary of State has consulted local authorities on changes to the capital financing system and is proposing to revoke most of the present secondary legislation relating to the requirement to make a Minimum Revenue Provision (MRP) to repay borrowing over time, and replace it with a new regulation containing a duty for local authorities each year to establish a level of MRP that it considers prudent. This will be backed up by statutory guidance which local authorities ‘must have regard to’. The guidance has not yet been confirmed, however, it is considered prudent to consider this issue now as part of the budget setting for the 2008/2009 financial year.

The draft guidance recommends authorities must submit to full Council an annual statement of its policy on making a MRP in respect of the following financial year and highlight which of the various options considered in the guidance will be followed.

5.2 For 2008/2009 having considered all of the options available to the Council it is proposed that the council will follow Option 1 for government supported borrowing. This is a continuation of the method currently used by the council (under the existing regulations 28 and 29 of the Capital Finance Regulations and the Local Government Act 2003) where MRP is calculated with regard to the ‘credit ceiling’ of the authority. This takes into account all loan advances and repayments through the Council’s consolidated advances and borrowing pool with MRP being calculated at 4% of the opening ‘credit ceiling’ balance.

Option 1 is preferred as this option takes the formulae used by the government in calculating revenue support grant as its basis which better reflects the actual funding provided by government.

5.3 The draft regulations also recommend consideration of two options for any future borrowing under the prudential system for which no government support is being given and is therefore self-financed.

Option 3 calculates MRP based on the life of the asset being enhanced. An assessment must be made of the asset life at the outset of the capital scheme and MRP is charged to revenue in equal annual instalments over the estimated life of the asset.

Option 4 calculates MRP in accordance with the standard rules for depreciation accounting for the particular asset being created or enhanced. Using this method the MRP charged may be subject to volatility as asset lives are reassessed.

Neither of the options suggested by the government reflects current council policy which is to accelerate debt repayments on unsupported borrowing through an increased voluntary MRP.

The council currently follows the criteria set out below for all unsupported borrowing and provides an increased voluntary MRP:

- In the case of invest to save schemes MRP is based on the payback period for any borrowing taken out up to a maximum of 7 years;
- In cases where a full option appraisal shows borrowing to offer better value for money than leasing MRP is based on the payment period that would have arisen had a lease been taken out instead of a loan;
- In the case of any form of grants for capital purposes that have been given in earlier years and any new grants given for which borrowing is taken out, MRP is based on the actual principal repayment schedule relating to the grant provided. This option is used for existing loans provided to Wearside College, mortgages provided in earlier years to householders under Right to Buy regulations, and loans to industry to support economic regeneration.

5.4 Given budget pressures it is proposed that, as in 2007/2008, opportunities for utilising the above framework be restricted to invest to save schemes, where a limited provision has been made within the budget and also where option appraisal of funding through borrowing instead of leasing is appropriate.

For the purposes of the proposed regulations Option 3 is recommended for self-financed borrowing as this method is subject to less potential variation than Option 4.

However, it is recommended to continue existing practice so that any unsupported borrowing schemes will be subject to an additional voluntary MRP repayment as shown in the criteria detailed in 5.3 above. For any unsupported borrowing taken out in support of trading services which are subject to market pressures it is recommended that discretion be afforded in relation to relaxing the additional voluntary MRP requirement and MRP is calculated using Option 3 only where deemed appropriate. This will mean that trading services would not be put at an unfair disadvantage in comparison to any of its potential competitors.

5.5 In summary, it is therefore recommended that the Council approves the following Annual Minimum Revenue Provision Statement for 2008/2009:

a) For all government supported borrowing the Council will adopt Option 1 as set out in the government's consultation paper which is a continuation of the basis upon which the Council currently calculates MRP as set out in paragraph 5.2 above.

b) For all unsupported borrowing the Council will adopt Option 3 as set out in the government's consultation paper.

The Council will also make additional voluntary MRP payments to that indicated by the adoption of Option 3 with reference to the Council's existing framework as detailed in 5.3 above, in order to make any increased voluntary MRP it considers prudent. This requirement may be relaxed for any unsupported borrowing taken out on behalf of trading services which are subject to market pressures.

6. The Prudential Code and Prudential Indicators

6.1 The Local Government Act 2003 gives statutory backing to the CIPFA Prudential Code for Capital Finance. The regulations specify that it is this Code to which authorities must have regard when setting and reviewing their affordable borrowing limits. The Prudential Code was reported to Council in March 2004.

6.2 The actual indicators arising from the Code, together with background to the indicators and what they are seeking to assess, are detailed in Appendix B.

7. Treasury Management

7.1 Treasury Management Policy

The Treasury Management Policy is set out in Appendix C. Cabinet is asked to note that no changes are proposed to the Policy.

7.2 Treasury Management Strategy

The Treasury Management Strategy comprises a Borrowing and an Investment Strategy. These are set out in Appendix D.

7.3 Treasury Limits for 2008/2009 to 2010/2011

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". This is the prudential indicator P5 at Appendix B and is otherwise known as the Authorised External Borrowing Limit.

The Council must have regard to the Prudential Code when setting the Affordable Borrowing 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 levels is ‘acceptable’.

Whilst termed an “Affordable Borrowing Limit”, the capital plans to be considered for inclusion, incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The affordable borrowing limit is set, on a rolling basis, for the forthcoming financial year and two successive financial years.

8. Alternative Options

8.1 No alternatives are submitted for Cabinet consideration.

9. Background Papers

Various Notifications regarding Capital Resources for 2008/2009 from Government Departments
Government’s Consultation paper on MRP
Royal Bank of Scotland – Chief Economist’s weekly brief
Sector City Watch (Monthly)
UBS – UK Economic Comment (Monthly)
Royal Bank of Scotland – Monthly Economic Update
ICAP Intercapital Monthly Newsletters
Royal Bank of Scotland – UK Quarterly Economic Outlook (Quarterly)
Stirling Brokers Monthly Outlook

Appendix A

Capital Programme 2008/2009

Environmental, Protective and Cultural Services (Other Services Block)

1. Introduction

1.1 Consideration has been given to the overall resource position facing the Council in respect of the Environmental, Protective and Cultural Services (Other Services Block), after taking account of the need to fund one off revenue spending pressures and also:

- the budget position of the Council following the Revenue Support Grant settlement for 2008/2009 and the outlook for the medium term;
- the need to provide for commitments arising from the 2007/2008 capital programme and variations thereto; and
- the requirement to provide resources to address various spending pressures linked to strategic priorities;

resources have been identified for proposed new starts in the 2008/2009 capital programme.

2. Overall Summary - Resources

EPCS – 'Other Services' Block

2.1 It is planned to take £2 million capital receipts expected to be received in 2008/2009 into account in funding the 'other services' capital programme. This is considered to be prudent based on an assessment of anticipated receipts.

Children's Services and Adult's Services

2.2 In accordance with the established resourcing principles capital receipts for Children's Services and Adult Services are earmarked for reinvestment in those services.

2.3 Whilst a prudent approach is taken to taking receipts into account in terms of resourcing, any slippage against expectations can result in temporary financing being provided either through the Strategic Investment Reserve or General Balances. It is anticipated that there will be delays in realisation of Children's Services capital receipts in 2007/2008. It is estimated therefore that temporary funding of £5.3 million will need to be provided from the Strategic Investment Reserve. The temporary funding will be repaid once expected receipts are realised.

2.4 Commitments into future years arising from 2007/2008 new starts have been provided for within the capital programme. After taking account of these commitments, a sum of £4.525 million is available for new starts in 2008/2009, funded through a combination of a Revenue Contribution to Capital Outlay and a contribution from General Balances.

3. Proposed New Starts / Provisions

3.1 Following consultation with portfolio holders potential new starts have been considered, in the context of strategic priorities, taking account of the following:

- Legal responsibilities;
- Health and Safety;
- Budget Consultation.

The following schemes are proposed for inclusion in the capital programme for 2008/2009 together with an increase in the existing provision for the proposed Barnes Park Development.

Flash Flooding and Highways Drainage £350,000

3.2 Over recent years there has been an increase in severe weather resulting in more occurrences of localised flash flooding. Drainage requests received across the city are investigated and prioritised. At present approximately 250 requests have been investigated with 100 outstanding. The current drainage budget is spent on regular maintenance of existing drainage to prevent flooding and on replacement gully tops. To tackle the backlog of requests capital funding of £300,000 is proposed to increase the size of drainage capacity by creating larger additional gullies. An additional sum of £50,000 is proposed to be allocated to carry out flood attenuation works to some of the highway drainage infrastructure. These works will ensure drainage infrastructure is more able to cope with expected future severe weather and reduce potential future highways maintenance costs that may arise from such severe weather.

Ryhope Beach Access Works £325,000

3.3 In order to re-establish access points to and from the beach between Hendon and Ryhope it is necessary to remove the existing structures at Salterfen and Ryhope Beach Road which are currently closed to the public. A new access point will be constructed at Ryhope Beach Road only, with Salterfen access remaining closed. The cost of the works including fees is estimated at £325,000.

ICT Disaster Recovery £100,000

3.4 An authority wide review of disaster recovery arrangements for directorate based and corporate ICT systems is underway. Pending the finalisation of that review it is difficult to estimate the one off costs that may need to be incurred to strengthen the disaster recovery arrangements. At this stage it is prudent to provide a sum of £100,000.

In addition, there are likely to be ongoing revenue consequences arising from maintaining the disaster recovery arrangements. Currently there is provision of £100,000 in the ICT unit base budget, and £80,000 in the Council's contingency provision. It is proposed to review the contingency provision to give flexibility to strengthen arrangements as necessary. An additional sum of £70,000 has therefore been provided at this stage.

Flexible Working Solutions £100,000

3.5 Funding for this project will allow flexible working pilots to be pump primed to enable the generation of efficiency savings through greater productivity and in respect of office accommodation costs through property rationalisation.

Core ICT Systems - Replacement Cash Receipting System £205,000

3.6 The current cash receipting system is 17 years old. Replacement hardware for the system is no longer available and any breakdowns to the system are very difficult to repair. The age of the system and software makes the ongoing ICT support for the system very difficult, and it cannot be effectively developed in order to meet the future business requirements of the Council and its customers.

Through the current cash receipting system, in excess of £800 million is received, identified, and allocated to the relevant financial system. The new system will ensure the continuity of service to customers and specifically will enable payments to continue to be accepted at the cashier's office and telephone payments to continue to be processed by the contact centre, as well as updating the relevant financial systems with the detailed transaction information and ensuring appropriate internal control arrangements are in place. Additional functionality will be included that will improve business processes through the use of technology (e.g. automating the update of the cash receipting system with transactions processed via the internet). It is proposed to earmark funding in capital contingencies and a detailed business case will be brought forward for approval prior to the resources being released.

Core ICT Systems – Archiving of SAP data £200,000

3.7 Options for archiving data within the SAP system are currently being reviewed. Without a solution, as the use of the system expands the performance of the system will start to be affected and may lead to system unavailability as the timeframe required for backing up the system data becomes extended. Pending completion of the review and consideration of the available options it is difficult to estimate the one off investment that may be required to deliver the solution. At this stage a sum of £200,000 has been proposed. It is proposed to earmark funding in capital contingencies and a detailed business case will be brought forward for approval prior to the resources being released.

Economic Development Provision 2008/2009 £800,000

3.8 This proposal seeks £800,000 to provide on-going support to a range of economic development projects and business initiatives that support investment and job creation activities in the city. It will provide a resource to deal with extraordinary or unforeseen opportunities that place excessive or substantial demands on existing budgets. It will cover both strategic investments in infrastructure and facilities for business, and support business growth and investment activities. Previous interventions include support for major inward investment projects, as well as infrastructure investments, such as Rainton Bridge Business Park, and highway improvements to facilitate employment site development.

Herrington Country Park £300,000

3.9 This project will facilitate an improvement to the infrastructure at Herrington Country Park. The aim is to enhance the parks capability and function from that of a Country Park to a facility that is capable of staging large-scale outdoor events of a regional and national significance on a regular basis. This includes a particular focus on music events.

Several areas of the park have been identified as requiring improvement and development to both maintain and substantially improve the park's ability to host an enhanced events programme. In particular work is required to vehicle access roads, public footpaths, car parks, drainage and cultivation, utilities, park administrative building, and signage provision. Outline approval has been given by ONE North East that, providing the Council is prepared to commit £300,000 towards the scheme, ONE North East will provide the remaining £700,000. A detailed scheme proposal will be brought before Cabinet for approval in due course.

Environmental Improvements - Public Art £250,000

3.10 The provision of £250,000 will enable a more strategic approach to commissioning, promoting and maintaining public art to ensure that Sunderland builds upon its reputation as a great place to live and work. Delivery will involve intensive consultation with all stakeholders including leading ward members and external partners. It will lever significant investment from the public and private sector and will assist in raising the profile of Sunderland.

Cultural Centre – The Arrival's Lounge £1,445,000

3.11 The **"**Arrivals Lounge" scheme will provide a new city centre based facility which will raise the profile of the cultural offer in the city, provide enhanced access to services and information and create an enhanced image of Sunderland. This is a natural extension of the current City Library and Arts Centre and will encompass the Tourist Information Centre and Local Studies operations to provide a 'seamless one stop facility'. The delivery of services will also involve volunteers from relevant community groups who will assist in telling the Sunderland story whilst receiving essential support to help sustain their activities going forward. It will create a sense of the city's past, present and future through the application of relevant technology and offer a powerful visual impact to showcase and signpost the city's heritage, landmarks and visitor attractions.

The overall estimated cost of the proposal is £3,842,000. There is a net cost of £1,445,000 in 2008/2009 (after taking into consideration external and other funding amounting to £360,000). The net cost in 2009/2010 is estimated to be £1,537,000 (after taking into consideration planned external funding of £500,000) and will be a first call against the funding available for the 2009/2010 capital programme.

3.12 **Sunderland Crematorium £150,000**
The three electric cremators have been operational for ten years and the internal refractory linings are now at the limits of their integrity. The necessary works will involve breaking out and replacing the existing linings and implementing modifications to improve the operation and maintenance requirements of the units. Minor modifications to the monitoring equipment on the remaining gas cremator will also be undertaken. The work will return the units to peak operating capacity.

3.13 **Barnes Park Development £300,000**
It was agreed by Cabinet on 8th November 2006 that Sunderland would submit one funding application to the Big Lottery Parks for People Fund for development works at Barnes Park. When the Cabinet paper was agreed the financial implications were based on an overall project cost of £1.5 million attracting 75% grant funding. Accordingly £375,000 was allocated in capital contingencies as part of the capital programme for 2007/2008.

Informal feedback from the Heritage Lottery Fund has suggested that the prospects of a regional application being successful are low due to resource constraints and that an application to the National Board would provide a much greater prospect for a successful application. To submit a project to the National Board, the overall contribution from the Big Lottery / Heritage Lottery Fund must be over £2 million and the overall project cost must be a minimum of £2.75 million. It is therefore proposed to increase the existing provision in capital contingencies by £300,000 to provide for matched funding requirements.

Appendix B

Prudential Indicators 2008/2009

Local Authorities are required to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003. The key objectives of the code are to ensure that the capital investment plans of Local Authorities are affordable, prudent and sustainable. A further key objective is to ensure that treasury management decisions are taken in accordance with good professional practice. The indicators that must be taken into account are shown below:

P1 The actual capital expenditure that was incurred in 2006/2007 was £84.150m and the estimates of capital expenditure to be incurred for the current and future years that are recommended for approval are:

	Capital Expenditure			
	2007/2008 £000 Estimate	**2008/2009 £000 Estimate**	**2009/2010 £000 Estimate**	**2010/2011 £000 Estimate**
Children's Services	18,760	91,923	47,915	14,780
Adult Services	1,614	1,369	682	607
Neighbourhood and Street Services	61	850	0	0
Housing and Public Health	5,295	5,149	4,455	4,455
Planning and Transportation	14,074	15,024	8,938	8,577
Culture and Leisure	13,184	8,593	8,173	0
Leader / Deputy Leader	3,130	3,114	0	0
Regeneration and Community Cohesion	6,080	5,298	0	0
Resources	2,350	1,155	0	0
Capital Contingency	529	921	2,130	0
Unallocated	0	0	0	31,581
Total	65,077	133,396	72,293	50,000

An estimate has been made of future spend on the basis of grants expected to be received in 2008/2009 onwards. Where no indication has been received as to whether a grant application will be approved it is thought to be prudent to exclude these capital schemes from the above estimates. In particular there is no provision included for the Central Route Highways scheme, which is subject to approval. The profile of expenditure will be updated in the quarterly capital reviews to Cabinet as further projects are approved.

P2 Estimates of the ratio of financing costs to net revenue stream for the current and future years, and the actual figures for 2006/2007 are:

Ratio of financing costs to net revenue stream

2006/2007 Actual	2007/2008 Estimate	2008/2009 Estimate	2009/2010 Estimate	2010/2011 Estimate
4.14%	3.88%	4.57%	5.03%	5.59%

The estimates of financing costs include current commitments and the proposals in this budget report. The forecasts show an anticipated decrease in the ratios of financing costs to net revenue stream than those previously reported due to an increase in the anticipated rate of return on investments and higher than anticipated investments. It should be noted that ratios will vary depending on the interest rate obtained on investments and the level of investment. If there is slippage in the use of grant funding in the capital programme then the ratios shown in the table above will decrease, whilst any reduction in the interest rate obtained on investments will lead to an increase in the reported ratios.

The ratio is expected to increase in future years reflecting the fact that significant amounts of expenditure are planned to be financed from earmarked reserves and this will lead to investment levels decreasing over time. As detailed in section 5.3 of the main report, there are planned voluntary increases to the statutory minimum revenue provision in order that any unsupported borrowing taken out and used to fund invest to save schemes is repaid over a shorter time period relating to the savings profile of the particular invest to save scheme. This will lead to a higher ratio in early years but lower ratios over the medium to long term.

The level of financing costs is considered to be affordable and has been taken into account when assessing the Medium Term Financial Strategy. Please see the report on the Revenue Budget and Proposed Council Tax for 2008/2009.

P3 Estimates of the end of year capital financing requirement for the Council for the current and future years and the actual capital financing requirement at 31 March 2007 are:

Capital financing requirement

31/03/07 £000 Actual	31/03/08 £000 Estimate	31/03/09 £000 Estimate	31/03/10 £000 Estimate	31/03/11 £000 Estimate
204,276	204,081	212,395	216,552	217,936

The capital financing requirement measures the authority's underlying need to borrow for a capital purpose. In accordance with best professional practice, Sunderland City Council does not associate individual borrowing taken out with particular items or types of expenditure. The Authority has an integrated treasury management strategy and has adopted the CIPFA Code of Practice for Treasury Management in the Public Services. The City Council has, at any point in time, a number of cashflows both positive and negative, and manages its treasury position in terms of its borrowings and investments in accordance with its approved treasury management strategy and practices. In day to day cash management, no distinction can be made between revenue cash and capital cash. External borrowing arises as a consequence of all the financial transactions of the authority and not simply those arising from capital spending. In contrast, the capital financing requirement reflects the authority's underlying need to borrow for a capital purpose.

The anticipated underlying need to borrow has reduced from the levels previously reported, primarily due to revisions made to the capital programme.

P4 CIPFA's Prudential Code for Capital Finance in Local Authorities includes the following as 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 net external borrowing does not, except in the short term, exceed the total of the 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 Authority had no difficulty meeting this requirement in 2006/2007, nor are there any difficulties envisaged for the current or future years. This view takes into account current commitments, existing plans, and the proposals in this report and the report elsewhere on today's agenda on the Revenue Budget and Proposed Council Tax 2008/2009.

P5 In respect of its external debt, it is recommended that the Council approves the following authorised limits for its total external debt gross of investments for the next three financial years, and agrees the continuation of the previously agreed limit for the current year since no change to this is necessary. These limits separately identify borrowing from other long-term liabilities such as finance leases. The Council is asked to approve these limits and to delegate authority to the City Treasurer, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities, in accordance with option appraisal and best value for the authority. Any such changes made will be reported to the Council at its next meeting following the change.

	Authorised Limit for External Debt			
	2007/2008 £000	2008/2009 £000	2009/2010 £000	2010/2011 £000
Borrowing	298,947	300,134	302,558	299,926
Other long term liabilities	1,579	1,568	3,063	4,558
Total	**300,526**	**301,702**	**305,621**	**304,484**

The City Treasurer reports that these authorised limits are consistent with the Authority's current commitments, existing plans and the proposals in this report for capital expenditure and financing, and with its approved treasury management policy statement and practices. The City Treasurer confirms that they are based on the estimate of most likely, prudent, but not worst case scenario, with, in addition, sufficient headroom over and above this to allow for operational management, for example unusual cash movements. Risk analysis and risk management strategies have been taken into account, as have plans for capital expenditure, estimates of the capital financing requirement and estimates of cash flow requirements for all purposes. It should be noted that the Council undertakes investment and borrowing on behalf of external bodies such as Tyne and Wear Fire and Rescue Authority. Treasury Management undertaken on behalf of other authorities is included in Sunderland's borrowing limits, however it is excluded when considering financing costs and when calculating net borrowing. A specific element for risk has also been taken into account for these bodies.

In taking its decisions on the Revenue Budget and Capital Programme for 2008/2009, the Council is asked to note that the authorised limit determined for 2008/2009, (see P5 above), will be the statutory limit determined under section 3(1) of the Local Government Act 2003.

P6 The Council is also asked to approve the following operational boundary for external debt for the same time period. The proposed operational boundary for external debt is based on the same estimates as the authorised limit, but reflects directly the estimate of the most likely, prudent but not worst case scenario level, without the additional headroom included within the authorised limit to allow for example for unusual cash movements, and equates to the maximum of external debt projected by this estimate. The operational boundary represents a key management tool for in year monitoring. Within the operational boundary, figures for borrowing and other long-term liabilities are separately identified. The Council is also asked to delegate authority to the City Treasurer, within the total operational boundary for any individual year, to effect movement between the separately agreed figures for borrowing and other long term liabilities, in a similar fashion to the authorised limit.

The operational boundary limit will be closely monitored and will be reported to Council if it is exceeded at any point. In any financial year, it is only expected that the actual debt outstanding will approach the operational boundary when all of the long-term borrowing has been undertaken for that particular year and will only be broken temporarily as a result of the timing of debt rescheduling.

Operational Boundary for External Debt

	2007/2008 £000	2008/2009 £000	2009/2010 £000	2010/2011 £000
Borrowing	218,018	221,710	219,097	216,054
Other long term liabilities	1,579	1,568	3,063	4,558
	219,597	**223,278**	**222,160**	**220,612**

P7 The Council's actual external debt at 31 March 2007 was £200.195 million. The Council does not plan to take out any long-term liabilities but has included an element for this in its calculation of the operational and authorised boundaries to allow flexibility over future financing. It should be noted that actual external debt is not directly comparable to the authorised limit and operational boundary, since the actual external debt reflects the position at one point in time and allowance needs to be made for cash flow variations.

P8 The estimate of the incremental impact of new capital decisions proposed in this report, over and above capital investment decisions that have previously been taken by the Council are:

For Band D Council Tax

2008/2009	2009/2010	2010/2011
£1.24	£5.66	£8.98

The estimates show the net revenue effect of all capital expenditure from all schemes commencing in 2008/2009 and the following two financial years. The impact on the Band D Council Tax detailed above takes account of estimated government grant funding through Formula Grant.

These forward estimates are not fixed and do not commit the Council. They are based on the Council's existing commitments, current plans and the capital plans detailed in this report. The cumulative effect of full year debt charges will have an additional impact of £10.88 in 2011/2012. There are no known significant variations beyond the above timeframe that would result from past events and decisions or the proposals in the budget report.

P9 Sunderland City Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Services.

P10 It is recommended that the Council sets an upper limit on its fixed interest rate exposures of £50 million in 2008/2009, £60 million in 2009/2010 and £90 million in 2010/2011.

P11 It is further recommended that the Council sets an upper limit on its variable interest rate exposures of £40 million in 2008/2009, £30 million in 2009/2010 and £25 million in 2010/2011.

In previous years these indicators (P10 and P11 above) were expressed as a percentage of the Council's net principal sum outstanding on it's borrowing/investments. It was reported to Cabinet on 7th November 2007 that in order to reduce the sensitivity of these measures they would no longer be expressed as a percentage but as absolute amounts.

P12 It is recommended that the Council sets upper and lower limits for the maturity structure of its borrowings as follows:

Amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate at the start of the period:

	Upper limit	**Lower limit**
Under 12 months	40%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and above	100%	0%

P13 A maximum maturity limit of £90 million is set for each financial year (2008/2009, 2009/2010 and 2010/2011) for long term investments, (those over 364 days), made by the authority. This gives additional flexibility to the Council in undertaking its Treasury Management function. Should the Council appoint any external fund managers during the year, these limits will be apportioned accordingly. The type of investments to be allowed are detailed in the Annual Investment Strategy (Appendix D).

At present the Council has £95.630 million of long-term investments. The main element of this is £83 million in term deposits, of which £5 million matures in the current financial year, £73 million matures in 2008/2009, and £5 million matures in 2009/2010. The remaining £12.609 million is the value of share capital held in NIAL Holdings PLC. This equates to a 9.41% share in Newcastle International Airport. The Council also holds £0.021 million in government securities, other shares and unit trusts.

The objective of the Code is to provide a framework for local authority capital finance that will ensure for individual local authorities that:

(a) capital expenditure plans are affordable;

(b) all external borrowing and other long term liabilities are within prudent and sustainable levels;

(c) treasury management decisions are taken in accordance with professional good practice;

and that in taking decisions in relation to (a) to (c) above the local authority is

(d) accountable, by providing a clear and transparent framework.

Further, the framework established by the Code should be consistent with and support:

(e) local strategic planning;

(f) local asset management planning;

(g) proper option appraisal.

In exceptional circumstances the objective of the Code is to provide a framework that will demonstrate that there is a danger of not ensuring the above, so that the Authority can take timely remedial action.

Appendix C

Treasury Management Policy Statement

1. The Council adopted the revised C.I.P.F.A. Code of Practice for Treasury Management in the Public Services on 20 November 2002. A major requirement of this Code relates to the need to have in place a Treasury Management Policy Statement (TMPS).

2. Under the TMPS the policies and objectives of treasury management activities are as follows:

   a) Treasury Management activities are defined as:

   “The management of the authority’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.”

   b) The successful identification, monitoring and control of risk are the prime criteria by which the effectiveness of treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

   c) Effective treasury management supports the achievement of the council’s business and service objectives. Consequently, there must be commitment to the principles of achieving best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

3. No change is proposed to the Council’s TMPS.

Appendix D

Treasury Management Strategy Statement

1. Introduction

1.1 The council has customarily considered an Annual Treasury Strategy Statement under the requirement of the CIPFA Code of Practice on Treasury Management, which was adopted by the Council on 20th November 2002. The 2003 Prudential Code for Capital Finance in Local Authorities introduced new requirements for the manner in which capital spending plans are to be considered and approved, and in conjunction with this, the development of an integrated Treasury Management Strategy.

1.2 The Prudential Code requires due regard to be had to the Prudential Indicators set out in Appendix B, when determining the Council's Treasury Management Strategy.

Borrowing Strategy

1.3 The suggested borrowing strategy for 2008/2009 in respect of the following aspects of the treasury management function is based upon the City Treasurer's views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor. The strategy covers:

- the past and current treasury position including interest rates
- the borrowing requirement 2008/2009
- the outlook for interest rates
- capital borrowings and borrowing strategy 2008/2009;
- debt rescheduling;

The Borrowing Strategy is set out in paragraphs 2 to 6 inclusive.

Annual Investment Strategy

1.4 The Investment Strategy comprises:

- investment objectives;
- security of capital: the use of credit ratings;
- investments defined as capital expenditure;
- provision for credit related losses;
- past performance and current position;
- outlook and proposed investment strategy 2008/2009;
- end of year report.

The Annual Investment Strategy is set out at paragraphs 7 to 13.

BORROWING STRATEGY

2. The Past and Current Treasury Position including Interest Rates

2.1 Interest Rates 2007/2008

2.1.1 Interest rates have varied during the current financial year as illustrated in the following table:

Loan Type	March 2007 %	January 2008 %	Difference %
7 Day Notice	5.30	5.50	0.20
1 Month	5.40	5.50	0.10
PWLB - 1 Year	5.60	4.41	-1.19
5 Year	5.40	4.45	-0.95
10 Years	5.10	4.57	-0.53
25 Years	4.80	4.49	-0.31
50 Years	4.45	4.45	0.00

Bank of England Base Rate moved as follows:

		%	
January	2007	5.25	(previous change)
May	2007	5.50	
July	2007	5.75	
December	2007	5.50	(latest change)

2.1.2 Shorter-term rates – the Base Rate started the financial year at 5.25% and steadily increased to 5.75% in July 2007. These increases were the result of the Bank of England's continued action to address inflationary pressures in the UK economy. As a result of the effect of the credit crunch in the financial markets and a general slow down in the economy, the Bank of England reduced the Base Rate to 5.50% in December.

2.1.3 Longer-term interest rates – Public Works Loan Board (PWLB) rates steadily increased to peak in July, approximately 0.50% higher than at the start of the financial year. This mirrored the increase in Base rates to that point. Rates then steadily reduced during the year, with the greatest reductions being at the shorter periods (1 to 15 years).

2.2 Long-term Borrowing 2007/2008

2.2.1 As part of the Treasury Management Policy and Strategy Statement which was included in the March 2007 Capital Programme Council report, a benchmark rate of 4.75% was set for all long-term borrowing to be undertaken in 2007/2008.

2.2.2 The borrowing requirement for 2007/2008 was undertaken in November 2006 when £8m was secured at the rate of 4.05%. The long-term rates were forecast to remain around 4.25% for 2007/2008 so it was considered prudent to undertake that year's borrowing requirement at the low point of 4.05%, which was 0.45% below the 2006/2007 Treasury Strategy's benchmark rate of 4.50%. Details of the loans are set out below:

Date	**Lender**	**Amount £m**	**Period (Years)**	**Rate %**	**Target Rate %**	**Margin %**	**Loan Type**
6/11/06	PWLB	7.0	49.0	4.05	4.5	(0.45)	Borrowing Requirement
6/11/06	PWLB	1.0 **	50.0	4.05	4.5	(0.45)	Borrowing Requirement
		8.0					
**This loan was for £7.0m but £6.0m was part of a rescheduling exercise							

2.2.3 The Treasury Management Strategy (paragraph 6.1) for 2007/2008 included provision for debt rescheduling as follows: "to secure further early debt redemption when (and if) appropriate opportunities arise. Consequently market conditions will be closely monitored to identify and take advantage of any such opportunities".

The Strategy also stated that because of the proactive approach taken by the Council in recent years, and because of the very low underlying rate of the Council's long term debt it would be difficult to refinance long term loans at interest rates lower than those already in place. For this reason, and the change in policy announced by the PWLB in November 2007 (please see below), no debt rescheduling has been undertaken during this financial year.

In November 2007 the PWLB introduced a new scheme for the premature repayment of loans without any consultation with local authorities. This scheme introduced a revised set of PWLB rates for new borrowing and a lower set of rates to be used for the rescheduling of debt. This will mean that the opportunities for debt rescheduling will be greatly reduced as the financial benefits have been significantly lowered. The council's retained consultants, Sector Treasury Services, have made approaches to the PWLB to request them to reconsider this scheme and revert to the previous regime, to date without success.

The Treasury Management team will continue to monitor market conditions and will secure further early debt redemption when and if appropriate opportunities arise. Any rescheduling undertaken will be reported to Cabinet as part of the current treasury management reporting procedure.

The strategy for the remainder of 2007/2008 is to continue to monitor interest rates and to take advantage of any debt rescheduling opportunities that may arise, however, due to the policy change announced by the PWLB these are thought to be very unlikely.

2.2.4 The Council also has nine market Lender's Option / Borrower's Option (LOBO) loans totalling £39.5 million. Of these £34.5 million were converted from stepped rate loans to flat rate loans in previous financial years.

The rescheduling of these LOBO's had the following effects:

- Lengthening the period of the loan resulting in a lower interest rate.
- Converting these loans from stepped rate loans (i.e. loans where the interest rate was fixed for an initial period, and then rose to an agreed higher rate) to flat rate loans (sometimes known as vanilla LOBO's) where the interest rate remains the same throughout the period of the loan.
- Reducing the Council's volatility levels by lengthening the 'roll-over' period from every six months to every three years.

The one unchanged LOBO detailed below, stepped up to the higher rate of 4.50% from the initial rate of 2.55% on 23rd April 2007.

Start Date	Lender	Amount £m	Period (Years)	Rate %	Fixed Period	Roll Over Period
21/10/03	Barclays	5.0	40	2.55	23/04/07	Every 6 Months

One 'roll-over' date (23rd October 2007) has now passed without the lender requesting a change in the rate of interest. The Lender still has the option at the end of each 'roll-over' period to vary the interest rate and the Council has the option to accept the new rate or repay the loan at that point.

The Treasury Management team will continue to monitor this loan for an opportunity to renegotiate the loan in a similar manner to the other LOBO's.

2.3 Current Portfolio Position

The Council's treasury portfolio position at 18th January 2008 is:

		Principal (£m)	Total (£m)	Average Rate (%)
Borrowing				
Fixed Rate Funding	PWLB	128.5		
	Market	34.5		
	Other	6.0	169.0	4.42
Variable Rate Funding	PWLB	0.0		
	Market	5.0		
	Temporary/ Other	26.2	31.2	5.45

Total Borrowing		**200.2**	**4.57**
Total Investments	In House	**213.3**	**5.71**

3. Borrowing Requirement 2008/2009

3.1 Future Borrowing Requirement

		2008/09 £m	2009/10 £m	2010/11 £m
1.	New Borrowing (net of MRP)	0.0	2.6	0.7
2.	Alternative financial arrangements	0.0	0. 0	0.0
3.	Replacement borrowing (PWLB)	0.0	0.0	0.0
4.	Replacement borrowing (Market)	5.6	0.0	0.0
5.	Market LOBO replacement (potential)	19.5	20.0	10.0
6.	Market LOBO replacement (forecast)	0.0	0.0	0.0
TOTAL – KNOWN (1+2+3+4+6)		**5.6**	**2.6**	**0.7**
TOTAL – POTENTIAL (1+2+3+4+5)		**19.5**	**22.6**	**10.7**

On 23rd November 2008 the £5.6 million of 11.75% redeemable stock will mature. The City Treasurer will review the position, in the light of prevailing market conditions, to decide the most appropriate action, (i.e. to replace the loan or alternatively to use investments).

4. The Outlook for Interest Rates

4.1 The Council appointed Sector Treasury Services as a treasury adviser to the Council and part of their service is to assist the Council to formulate a view on interest rates. Set out below, are a number of current City forecasts for short term or variable (the Bank of England Base Rate) and longer fixed interest rates.

4.2 Survey of Economic Forecasts

The table below shows the HM Treasury – November 2007 summary of forecasts of 24 City and 13 academic analysts for Q4 2007 and Q4 2008 and the average 2009 to 2011 are based on 21 forecasts provided:

Bank Rate Forecasts		Quarter ended		Annual average Bank Rate		
	Actual %	Q4 2007 %	Q4 2008 %	Average 2009 %	Average 2010 %	Average 2011 %
Median	5.75	5.80	5.30	5.24	5.22	5.26
Highest	5.75	5.80	6.30	6.00	6.00	6.00
Lowest	5.75	5.30	4.80	4.50	4.06	4.00

Sector Interest Rate Forecasts provided on 31st January 2008 are set out in the table overleaf:

	2007/08	2008/09				2009/10				2010/11			
	Q1 2008 %	Q2 2008 %	Q3 2008 %	Q4 2008 %	Q1 2009 %	Q2 2009 %	Q3 2009 %	Q4 2009 %	Q1 2010 %	Q2 2010 %	Q3 2010 %	Q4 2010 %	Q1 2011 %
Bank Rate	5.25	5.00	4.75	4.75	4.75	4.75	4.75	5.00	5.00	5.00	5.00	5.00	5.00
PWLB 5yr	4.55	4.55	4.50	4.50	4.55	4.65	4.70	4.75	4.80	4.85	4.85	4.85	4.85
PWLB 10 yr	4.60	4.55	4.50	4.50	4.55	4.55	4.65	4.70	4.75	4.80	4.80	4.80	4.80
PWLB 25y	4.55	4.50	4.50	4.50	4.50	4.55	4.60	4.65	4.70	4.70	4.70	4.70	4.75
PWLB 50yr	4.50	4.45	4.45	4.45	4.45	4.50	4.55	4.60	4.60	4.65	4.55	4.55	4.60

4.3 Economic Background

4.3.1 International

- The US, UK and EU economies have all been on the upswing of the economic cycle during 2005 and 2006 and so interest rates were successively raised in order to cool their economies and to counter the build up of inflationary pressures.
- The US is ahead of both the UK and EU in the business cycle and started on the downswing of the economic cycle during 2007. The Federal Reserve (Fed) rate peaked at 5.25% and was first cut in September 2007 by 0.5% to 4.75%. This was a response to the rapidly deteriorating prospects for the economy in the face of the downturn in the housing market, the sub prime mortgage crisis and the ensuing liquidity crisis which started in August 2007 and has subsequently resulted in banks making some major write offs of losses on debt instruments containing sub prime mortgages, (more commonly known as the credit crunch). Banks have also tightened their lending criteria which has hit hard those consumers with poor credit standing.
- The Fed cut its rate to 4.5% in October 2007, 4.25% in December and again in January 2008 to 3.0% to try to stimulate the economy and to ameliorate the extent of the downturn. However, the speed and extent of these cuts will be inhibited by inflationary pressures arising from oil prices, the falling dollar increasing the costs of imports, etc. The US could well be heading into stagflation in 2008 – a combination of inflation and a static economy (but the economy could even tip into recession if the housing downturn becomes severe enough).
- The major feature of the US economy is an increasing downturn in the housing market which is being undermined by an excess stock of unsold houses stoked by defaulting sub prime borrowers pushed into forced sales. Falling house prices will also undermine household wealth and so lead to an increase in savings (which fell while house prices were rising healthily) and so conversely will lead to a fall in consumer expenditure. Petrol prices have trebled

since 2003 and, with similar increases in the price of home heating oil, this will also depress consumer spending with knock on effects on house building, employment etc.

- The downturn in economic growth in the US in 2008 will depress world growth, (especially in the western economies), which will also suffer directly under the impact of high oil prices. However strong growth in China and India will partially counteract some of this negative pressure.
- EU growth has been strong during 2006 and 2007 but will be caught by the general downturn in world growth in 2008.

4.3.2 United Kingdom (UK)

- Gross Domestic Product (GDP): growth has been strong during 2007 and hit 3.3% year on year in Q3. Growth is expected to cool from 3.0% in 2007 as a whole to 2.0% in 2008.
- Higher than expected immigration from Eastern Europe has underpinned strong growth and dampened wage inflation.
- House prices started on the downswing in Q3 2007 and this is expected to continue into 2008.
- The combination of increases in the Bank Rate and hence mortgage rates, short term mortgage fixes expiring and being renewed at higher rates, food prices rising at their fastest rate since 1993 and increases in petrol prices, have all put consumer spending power under major pressure.
- Banks have also tightened their lending criteria since the sub prime crisis, (the credit crunch), started and that will also dampen consumer expenditure via credit cards and on buying houses through obtaining mortgages.
- Government expenditure will be held under a tight reign for the next few years, undermining one of the main props of strong growth during this decade.
- The Monetary Policy Committee (MPC) is very concerned at the build up of inflationary pressures especially the rise in the oil price to $90 – $100 per barrel (was $30 in 2003) and the consequent likely knock on effects on general prices. The prices of UK manufactured goods have risen at the fastest rate in sixteen years in November 2007 at 4.5%. Food prices have also risen at their fastest rate for fourteen years, (6.6% annual increase), driven by strong demand from China and India. Consequently, the MPC is likely to be much more cautious about cutting rates compared to the Fed. in the face of these very visible inflationary pressures. In addition, UK growth was still exceptionally strong in Q3, as has the growth in the money supply. The downward trend in the Bank Rate is now expected to be faster than at first thought after the initial cut in December 2007 to 5.5% in view of the MPC minutes which showed a unanimous MPC vote for a cut and the consideration given to a half per cent cut. This demonstrated how concerned the MPC is at the potential impact of the credit crunch on the economies of the western world. Furthermore, the slow down in the economy may be more severe than had been initially predicted resulting in the MPC cutting rates by a further 0.75% by Q3 2008.

4.4 Base Rate Forecast

As stated above, Sector expects the Bank Base Rate to be cut by a further 0.75% over the course of the next three quarters, then expects this to stay steady at 4.75% through to Q3 2009. There is a downside risk to their forecast in the near term if output slows down more markedly than expected. However, there are upside risks in the medium to longer term if inflationary pressures do not subside. UBS on the other hand are predicting the Base Rate to fall to 4.50% by the end of 2008 and to remain at that level for 2009.

4.5 Long-term PWLB Rates

With regard to the PWLB interest rates, the shorter periods are more influenced by the Base Rate whereas the longer periods are more sensitive to inflation, both actual and expected. Sector is forecasting the PWLB rates to be at their lowest in Q4 2008 and are then projected to slowly increase over the next two years, the largest increase being in the 5 year rate (0.35%) with an increase of 0.20% at the longer end.

5. Capital Borrowings and Borrowing Strategy for 2008/2009

5.1 Variable rate borrowing is expected to become cheaper with the Base Rate being forecast to fall to 4.75% in Q3 2008. Thereafter variable rate borrowing is expected to remain at this level until Q3 2009 before rising back to 5.0% for the next two years.

The forecast for the long-term PWLB rates is to remain around their current levels, (i.e. 25 year – 4.50% and 50 year – 4.45%), during 2008, before slowly increasing by the end of 2010/2011 to 4.70% for 25 year and 4.65% for 50 year.

The City Treasurer will monitor the interest rate market and adopt a pragmatic approach to any changing circumstances, reporting any decisions to Cabinet as part of established reporting procedures for Treasury Management.

5.2 Sensitivities of the Forecast

The main sensitivities of the forecast are likely to be the two scenarios below. Council officers, in conjunction with our treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

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

- If it was felt that there was a significant risk of a sharp fall in long and short term borrowing rates, for example if growth rates remained low or were weakening, then long term borrowings would be postponed, and any rescheduling from fixed rate funding into variable or short rate funding would be exercised.

The City Treasurer in conjunction with treasury adviser's guidance considers a benchmark financing rate of 4.50% for any further long-term borrowing for 2008/2009 to be appropriate. With long-term interest rate forecasts set to remain around their current levels that level is considered appropriate as the long-term borrowing rate benchmark limit for 2008/2009.

It is possible that if short-term rates fall well below long-term rates, some investment balances will be used to fund the borrowing requirement in 2008/2009. In addition, the Council may not need to borrow further depending upon the completion of various capital schemes. However the need to adapt to changing circumstances will be required, and flexibility will be retained to adapt to such changes.

The City Treasurer, in conjunction with treasury advisers will continue to monitor rates closely, and whilst carrying out the borrowing strategy, will adopt a pragmatic approach in identifying the low points in the interest rate cycle at which to borrow.

6. Debt Rescheduling

6.1 The reasons for any rescheduling to take place will include:

- The generation of cash savings at minimum risk;
- In order to help fulfil the strategy; and
- In order to enhance the balance of the long-term portfolio (by amending the maturity profile and/or the balance of volatility).

In previous years debt rescheduling has achieved significant savings in interest charges and discounts and these interest savings have been secured for many years to come.

Given long-term interest rate projections for 2008/2009 and following the proactive approach taken to debt rescheduling over recent years, it seems unlikely that there will be many debt rescheduling opportunities in 2008/2009. The very low underlying rate of the Council's external debt, together with the new regime introduced by the PWLB, means that it will be difficult to refinance long term loans at interest rates lower than those already in place.

It is still intended to secure further early debt redemption when, and if, appropriate opportunities arise. Consequently, market conditions will be closely monitored to identify and take advantage of any such opportunities. The timing of all debt repayment is crucial. The timing of all borrowing and investment decisions inevitably includes an element of risk, as those decisions are based upon expectations of future interest rates. The policy to date has been very firmly one of risk spread and this will be continued.

Any rescheduling undertaken will be reported to Cabinet, as part of the current treasury management reporting procedure.

Annual Investment Strategy

7. Introduction

7.1 This Council has regard to the Government Guidance on Local Government Investments and the Chartered Institute of Public Finance and Accountancy's (CIPFA's) Treasury Management in Public Services: Code of Practice and Cross Sectoral Guidance Notes (CIPFA TM Code).

7.2 This Annual Investment Strategy (AIS) is a requirement under the Government's Guidance on Local Government Investments. The AIS states which investments the Council may use for the prudent management of its treasury balances during the financial year under the heads of **Specified Investments** and **Non-Specified Investments**.   Under the prudential code and Government Guidance of Local Government Investments it is possible to use non-specified investments as approved investments. Non-specified investments, (which are for greater than one year – up to a maximum of 5 years), clearly present a higher risk that the previous 364-day investment limit.

7.3 This Strategy sets out:

- the procedures for determining the use of each asset class, (advantages and associated risk), particularly if the investment falls under the category of "non-specified investments";
- the maximum periods for which funds may be prudently committed in each asset class;
- the amount or percentage limit to be invested in each asset class;
- whether the investment instrument is to be used by the Council's in-house officers and/or by the Council's appointed external fund managers, (if used); and, if non-specified investments are to be used in-house, whether prior professional advice is to be sought from the Council's treasury advisers;
- the minimum amount to be held in short-term investments (i.e. one which the Council may require to be repaid or redeemed within 12 months of making the Investment).

8. Investment Objectives

8.1 All investments will be in pounds sterling. The general policy objective for this Council is the prudent investment of its treasury balances. The Council's investment priorities are:

(a) The **security** of capital and

(b) The **liquidity** of its investments.

The council will aim to achieve the **optimum return** on its investments commensurate with the proper levels of security and liquidity.

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

9. Security of Capital: The Use of Credit Ratings

9.1 The Council relies on credit ratings published by Fitch IBCA to establish the credit quality of counterparties. The credit rating criteria used to identify "Approved Organisations for Investments" and their Authorised Investment Limits are consistent with those previously approved by Cabinet and are set out in Appendix E.

9.2 Monitoring of credit ratings:

- All credit ratings will be monitored on a daily basis. The Council has access to Fitch credit ratings and is alerted to changes through its use of the Sector Treasury Services website.

- If a counterparty's rating is downgraded with the result that it no longer meets the Council's minimum criteria, the counterparty will be withdrawn from the Council's Approved Lending List. The Council will also immediately inform its external fund manager(s), if used, of the withdrawal of the same.

- If a counterparty's rating is downgraded with the result that that rating is still sufficient for it to remain on the Approved Lending List, the counterparty's authorised investment limit will be reviewed accordingly. The downgraded credit rating may result in the lowering of the counterparty's investment limit. The Council will also immediately inform its external fund manager(s), if used, of the change(s).

- If fund managers are employed by the Council, the Council will establish with its fund manager(s) their credit criteria and the frequency of their monitoring of credit ratings so as to be satisfied as to their adherence to the Council's policy.

9.3 In view of the recent turmoil in the financial markets, brought about mainly by the "credit crunch", Cabinet is asked to note that the City Treasurer, taking account of independent advice from the Council's retained consultants, as appropriate, will make tactical decisions regarding investing with institutions on the Approved Lending List and the length of the loans as appropriate, and where information is available.

10. Investments defined as capital expenditure

10.1 The acquisition of share capital or loan capital in any body corporate is defined as capital expenditure under Section 16(2) of the Local Government Act 2003. Such investments will have to be funded out of capital or revenue resources and will be classified as 'non-specified investments'.

10.2 A loan or grant by this Council to another body for capital expenditure by that body is also deemed by regulation to be capital expenditure by the Council. It is therefore important for the Council to clearly identify if the loan has been made for policy reasons or if it is an investment for treasury management purposes. The latter will be governed by the framework set by the Council for 'specified' and 'non-specified' investments.

10.3 The Council will not use or allow any external fund managers it may appoint to use, any investment, which will be deemed as capital expenditure.

11. Provisions for Credit related losses

11.1 If any of the Council's investments appear at risk of loss due to default, (i.e. a credit-related loss, and not one resulting from a fall in price due to movements in interest rates), then the Council will make revenue provision of an appropriate amount.

12. Past Performance and Current Position

12.1 During 2007/2008 the Council did not employ any external fund managers, all funds being managed by the Council's in-house team.

The performance of the fund by the in-house team is shown below and compares this with the previous years performance:

	2006/07 Return %	**2006/07 Benchmark %**	**2007/08 Return % Year to date**	**2007/08 Benchmark % Year to date**
Council	4.85	4.78	5.71	5.64

12.2 During 2008/2009 the Council will continue to review the optimum arrangements for the investment of its funds.

13. Outlook and Proposed Investment Strategy 2008/2009

13.1 Based on its cash flow forecasts, the Council anticipates its fund balances in 2008/2009 are likely to range between £160m and

£220m which represents a cautious approach and provides for unanticipated levels of advanced funding through grants and for unexpected and unplanned levels of slippage and under-spending. However in 2008/2009, if short-term interest rates fall materially below long-term rates, it is possible that some investment balances may be used to fund some long-term borrowing. Such funding is wholly dependent upon market conditions and will be assessed and reported to Cabinet if and when the appropriate conditions arise.

13.2 The Council is not committed to any investments, which are due to commence in 2008/2009, (i.e. it has not agreed any forward deals).

13.3 Activities likely to have a significant effect on investment balances are:

- Capital expenditure during the financial year, (dependent upon timing), will affect cash flow and short term investment balances;
- Any slippage in capital expenditure from, and to, other financial years will also affect cash flow, (no slippage has been taken into account in current estimates);
- Any unexpected capital receipts or income;
- Timing of new long-term borrowing to fund capital expenditure;
- Possible funding of long-term borrowing from investment balances, (dependent upon appropriate market conditions).

13.4 The minimum amount of overall investments that the Council will hold in short-term investments (less than one year) is £50m. As the Council has decided to restrict most of its investments to term deposits, it will maintain liquidity by having a minimum of 50% of these short-term investments maturing within 6 months.

13.5 A maximum of £100m is to be set for in-house non-specified investments over 364 days up to a maximum period of 2 years. The City Treasurer will monitor long-term investment rates and identify any investment opportunities if market conditions change. This will enable the Council to invest balances available from sources such as the Strategic Investment Reserve, Schools, the Insurance Reserve and balances from slippage of the capital programme.

13.6 The type of investments to be used by the in-house team will be limited to term deposits and will follow the criteria as set out in Appendix E.

13.7 The City Treasurer, in conjunction with the Council's treasury advisor Sector Treasury Services, and taking into account the minimum amount to be maintained in short-term investments has, and will continue to, look to lengthen the average investment periods to lock in at the better investment returns that are currently available. It is expected that investment rates will fall as 2008/2009 progresses. The strategy will continue to monitor investment rates closely and to identify any appropriate investment opportunities that arise.

13.8 The Council will also agree strict investment limits and investment criteria with any external fund managers it may appoint. These external fund managers will work to the following parameters:

- The institutions on the Approved Lending list of the external manager must correspond to those agreed with Sunderland City Council (i.e. only institutions on Sunderland City Council's Approved Lending List to be included as shown in Appendix E);
- they will be allowed to invest in term deposits, Certificates of Deposit (CD's) and government gilt securities;
- An investment limit of £3m per institution (per manager);
- A maximum limit of 50% fund exposure to government gilts;
- A maximum limit of 10% fund exposure to supranational investments;
- A maximum proportion of the fund invested in instruments carrying rates of interest for periods longer than 364 days shall not exceed 50%. Again, it is proposed to only recommend the use of fixed term deposits up to a maximum of 2 years.

13.9 The details regarding the types of investment and the time periods to be permitted for investments are detailed in the Council's Approved Lending List (Appendix F).

14. End of Year Report

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

Appendix E

LENDING LIST CRITERIA

As approved by Council as at 7th November 2007

Fitch IBCA Long-term Credit Ratings

Long-term Credit Ratings generally cover periods of investment up to a maximum of 5 years.

		£m	Council Investment Period
AAA, AA+ or AA	Maximum Investment Limit	20	2 Years
AA-	Maximum Investment Limit	15	364 Days
A+ or A	Maximum Investment Limit	10	364 Days
Below A	Maximum Investment Limit	5	364 Days

Fitch IBCA / Moody's Short-term Ratings

Short-term Credit Ratings cover periods up to 1 year.

Investment periods can be determined by Fitch IBCA/Moody's short-term ratings.

Fitch IBCA / Moody's		
F1 or F1+/ P-1	Max.Period	364 Days
Fitch IBCA / Moody's		
F2 or P-2	Max.Period	6 Months

APPENDIX F

Sunderland City Council

Approved Lending List

The list reflects the credit rating changes made since November 2007:

Institution	Country	Fitch IBCA Long Term	Fitch IBCA Short Term	Moody's Long Term	Moody's Short Term	Total Limit £m	Max. Deposit Period
Abbey National plc	UK	AA-	F1+	Aa3	P-1	15	364 days
Alliance & Leicester plc	UK	AA-	F1+	Aa3	P-1	15	364 days
Bank of Scotland	UK	AA+	F1+	Aa1	P-1	20	2 years
Barclays Bank plc	UK	AA+	F1+	Aa1	P-1	20	2 years
HSBC Bank plc	UK	AA	F1+	Aa1	P-1	20	2 years
Lloyds TSB Bank plc	UK	AA+	F1+	Aaa	P-1	20	2 years
National Westminster Bank / Royal Bank of Scotland	UK	AA+	F1+	Aaa	P-1	20	2 years
Northern Rock plc	UK	A-	F1	Aa3	P-1	5	6 Months
Australia & New Zealand Banking Group Ltd.	Australia	AA-	F1+	Aa1	P-1	15	364 days
Commonwealth Bank of Australia	Australia	AA	F1+	Aa1	P-1	20	2 years
National Australia Bank Ltd	Australia	AA	F1+	Aa1	P-1	20	2 years
Westpac Banking Corporation	Australia	AA-	F1+	Aa1	P-1	15	364 days
Dexia Bank Belgium	Belgium	AA+	F1+	Aa1	P-1	20	2 years
Fortis Bank	Belgium	AA-	F1+	Aa2	P-1	15	364 days
KBC Bank	Belgium	AA-	F1+	Aa2	P-1	15	364 days
Bank of Montreal	Canada	AA-	F1+	Aa1	P-1	15	364 days
Bank of Nova Scotia	Canada	AA-	F1+	Aa1	P-1	15	364 days
Canadian Imperial Bank of Commerce	Canada	AA-	F1+	Aa2	P-1	15	364 days
Royal Bank of Canada	Canada	AA	F1+	Aaa	P-1	20	2 years
Toronto-Dominion Bank	Canada	AA-	F1+	Aaa	P-1	15	364 days
Danske Bank AS	Denmark	AA-	F1+	Aa1	P-1	15	364 days
BNP Paribas	France	AA	F1+	Aa1	P-1	20	2 years
Calyon	France	AA	F1+	Aa1	P-1	20	2 years

Institution	Country	Fitch IBCA Long Term	Fitch IBCA Short Term	Moody's Long Term	Moody's Short Term	Total Limit £m	Max. Deposit Period
Credit Agricole SA	France	AA	F1+	Aa1	P-1	20	2 years
Dexia Credit Local	France	AA+	F1+	Aa1	P-1	20	2 years
Societe Generale	France	AA-	F1+	Aa2	P-1	15	364 days
Deutsche Bank AG	Germany	AA-	F1+	Aa1	P-1	15	364 days
Allied Irish Banks plc	Ireland	AA-	F1+	Aa2	P-1	15	364 days
Bank of Ireland	Ireland	AA-	F1+	Aa2	P-1	15	364 days
Fortis Banque Luxembourg SA.	Luxembourg	AA-	F1+	Aa2	P-1	15	364 days
ABN Amro Bank NV	Holland	AA-	F1+	Aa2	P-1	15	364 days
ING Bank NV	Holland	AA	F1+	Aa1	P-1	20	2 years
Rabobank International	Holland	AA+	F1+	Aaa	P-1	20	2 years
Banco Bilbao Vizcaya Argenteria (BBVA)	Spain	AA-	F1+	Aa1	P-1	15	364 days
Banco Santander Central Hispano	Spain	AA	F1+	Aa1	P-1	20	2 years
Svenska Handelsbanken AB	Sweden	AA-	F1+	Aa1	P-1	15	364 days
Credit Suisse	Switz'land	AA-	F1+	Aa1	P-1	15	364 days
UBS AG	Switz'land	AA	F1+	Aaa	P-1	20	2 years
Bank of America N.A.	USA	AA	F1+	Aaa	P-1	20	2 years
Bank of New York	USA	AA-	F1+	Aaa	P-1	15	364 days
Citibank N.A.	USA	AA	F1+	Aaa	P-1	20	2 years
State Street Bank & Trust Co	USA	AA-	F1+	Aa1	P-1	15	364 days
Top 10 Building Societies							
Nationwide Building Society	UK	AA-	F1+	Aa2	P-1	15	364 days
Britannia Building Society	UK	A+	F1	A2	P-1	10	364 days
Yorkshire Building Society	UK	A+	F1	A2	P-1	10	364 days
Coventry Building Society	UK	A	F1	A2	P-1	10	364 days
Chelsea Building Society	UK	A	F1	A2	P-1	10	364 days
Leeds Building Society	UK	A	F1	A2	P-1	10	364 days
Derbyshire Building Society	UK			A2	P-1	5	6 months
West Bromwich Building Society	UK	A	F1	A2	P-1	10	364 days
Skipton Building Society	UK	A	F1	A2	P-1	10	364 days

Institution	Country	Fitch IBCA Long Term	Fitch IBCA Short Term	Moody's Long Term	Moody's Short Term	Total Limit £m	Max. Deposit Period
Principality Building Society	UK	A	F1	A2	P-1	10	364 days
Approved for Fund Managers Only							
Supranational Organisations:							
European Investment Bank		AAA	F1+	Aaa	P-1	20	2 years
International Bank Of Reconstruction and Development		AAA	F1+	Aaa	P-1	20	2 years