

**Cabinet – 10th February, 2010**

**Capital Programme 2010/2011 including Prudential Indicators and Treasury Management Strategy and Policy**

**Report of the Chief Executive and Director of Financial Resources**

**1. Purpose of Report:**

- 1.1 To update Cabinet of the level of capital resources and commitments for the forthcoming financial year and seek a recommendation to Council to the overall Capital Programme 2010/2011, the Prudential Indicators, and the Treasury Management Strategy and Policy for 2010/2011.

**2. Description of Decision:**

- 2.1 Cabinet is requested to:

- recommend to Council approval of:
  - the proposed Capital Programme for 2010/2011;
  - the prudential indicators and revisions to the operational limit for 2009/2010;
  - the Annual Minimum Revenue Provision statement for 2010/2011 and adjustments to 2009/2010;
  - the Annual Treasury Management Strategy including specifically the Annual Borrowing and Investment Strategies;
  - the adoption of the revised CIPFA Treasury Management Code of Practice 2009;
  - the Treasury Management Policy Statement.

**3. Capital Programme 2010/2011**

- 3.1 As reported to Cabinet in January 2010, and in accordance with the Council's Capital Strategy, resources for the main programme areas of Children's Services, Adult Services, Highways, and Housing have been allocated on the basis of their Supported Capital Expenditure (SCE (R)) approvals and other service specific resources.
- 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 together with any proposals for additional schemes as appropriate.

- 3.3 Due to the continuing impact of the economic downturn and the fact that the housing market is still depressed, economic recovery is expected to be slow. As a result, very few capital receipts have been, or are anticipated to be received in 2009/2010 and it will be necessary to continue to use temporary funding from the Strategic Investment Reserve to fund high priority capital programme plans and commitments.

In assessing the overall resources position, an assessment has been made of the capital programme and a range of potential sources of funding including:

- Debt Charge Savings;
- Contingency Savings, including provision for the future strategic waste solution;
- VAT Refunds;
- Government Grants etc.

Taking account of the above, therefore, the Revenue Budget can provide funding of £15.068 million to support 'one off' revenue budget commitments and proposals and to assist in funding the Capital Programme.

In the light of the above, it is proposed that:

- £6.876 million of this sum is used to support one off revenue budget commitments and proposals;
- £8.192 million is used to support the capital programme for 2010/2011.

- 3.4 Since the January 2010 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 given to relevant factors to be taken into account in determining priorities set out in the Council's Capital Strategy and the outcome of budget consultation.
- 3.5 The recommended Capital Programme is included in full as Appendix A to this report. A summary of proposed new starts for the Environmental Protective and Cultural Services (Other Services) Block is set out at Appendix B. Proposed new starts for Children's Services, Adult Services, Housing, and Highways are detailed within Appendix C.
- 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, the outputs and outcomes expected together with funding sources and the consequential revenue implications.

- 3.7 For schemes / projects below £250,000, full capital investment appraisal documentation will be prepared and consultation will take place with the relevant Cabinet Portfolio Holder in advance of delegated decisions being taken to implement these schemes / projects.

#### **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. This allows the Council to manage and control its capital programme and how it is financed. The key elements of control and management of capital finance are through:

- capital expenditure plans – the Council's capital programme;
- external debt - how the Council proposes to fund its capital programme;
- treasury management – the management of the Council's investments, cash flows, banking, money market and capital market transactions, the effective control of risks associated with those activities and the pursuit of optimum performance consistent with those risks.

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.

#### **5. The Prudential Code and Prudential Indicators**

- 5.1 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.

CIPFA has issued a revised Prudential Code in 2009 with a number of indicators being removed from the Prudential Code and becoming part of the CIPFA Treasury Management in the Public Services Code of Practice.

The following indicators, previously included in the Prudential Code, now form part of the CIPFA Treasury Management in the Public Services Code of Practice but have been included alongside Prudential Code indicators in Appendix D for ease of reference:

<b>Indicator</b>	<b>Appendix D Reference</b>
Upper limit on fixed interest rate exposure.	P10
Upper limit on variable interest rate exposure.	P11
Upper limit for the maturity structure of borrowing.	P12
Lower limit for the maturity structure of borrowing.	P12
Prudential limit for principal sums invested for periods longer than 364 days.	P13

All of the above indicators together with background information to these indicators and what they are seeking to assess, are detailed in Appendix D in full compliance with the revised code.

- 5.2 It should be noted that accounting regulations relating to the introduction of International Financial Reporting Standards (IFRS) are being introduced from 1<sup>st</sup> April 2010 that are likely to affect a number of the Council's prudential indicators. In particular, changes to accounting standards for PFI schemes and leasing may require these assets to be brought onto the Council's Balance Sheet. This will result in an increase to the Council's capital financing requirement, authorised limit for external debt, and its operational boundary for external debt. These adjustments are technical in nature and a prudent amount has been added to all limits for 2010/2011 onwards to reflect these adjustments. This is in accordance with government and accounting guidance which has not yet been finalised and is therefore subject to further changes as necessary. It is considered likely that the Council's operational boundary for 2009/2010 of £227.212 million will be exceeded as a result of these changes and Cabinet is asked to recommend to Council a revision to the Council's operational boundary for external debt for 2009/2010 of £292.481 million.

## **6. The Annual Minimum Revenue Provision Statement**

- 6.1 Regulations came into force on 31<sup>st</sup> March 2008 revoking secondary legislation relating to the requirement to make a Minimum Revenue Provision (MRP) to repay borrowing over time, and replacing the legislation with a new regulation containing a duty for local authorities, each year, to determine for the current financial year, an amount of MRP that it considers prudent. The Department for Communities and Local Government (DCLG) has provided statutory guidance on the

methodology to use, which local authorities 'must have regard to'.

The guidance recommends that 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 set out in their guidance will be followed.

- 6.2 Provision for the repayment of debt is considered to be prudent where the period of repayment is either reasonably commensurate with that over which the capital expenditure to which it relates provides benefits, or in the case of borrowing supported by government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.
- 6.3 The four options for calculating MRP which were set out in the guidance can be summarised as follows:
- Option 1 – Regulatory Method: applying the statutory formula set out in the 2003 Regulations before it was revoked in 2008.
  - Option 2 – Capital Financing Requirement (CFR) Method: multiplying the CFR at the end of the preceding financial year by 4%.
  - Option 3 – Asset Life Method: amortising expenditure over an estimated useful life for the relevant assets created. An assessment must be made of the asset life at the outset of the capital scheme and MRP is charged to revenue in either equal annual instalments or by an annuity method over the estimated life of the asset. The MRP charge will commence in the financial year following the one in which the asset comes into service.
  - Option 4 – Depreciation Method: making charges to revenue in accordance with the standard rules for depreciation accounting for the particular asset being created or enhanced.
- 6.4 For 2010/2011, having considered all of the options available to the Council, it is proposed that the Council use Option 1 (the Regulatory Method) 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 and better reflects the actual funding provided by government.
- 6.5 Neither of the two options recommended for future borrowing, for which no government support is being given and is therefore self-financed

(options 3 and 4), reflect current Council policy to accelerate debt repayments on unsupported borrowing through an increased voluntary MRP. The depreciation method for calculating MRP is also subject to volatility when asset lives are reassessed as part of the revaluation process.

6.6 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 (this requirement is relaxed where unsupported borrowing is taken out on behalf of trading services, which are subject to market pressures);
- 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.

6.7 Given budget pressures it is proposed that opportunities for utilising the above framework be restricted to strategic priorities and invest to save schemes, where a 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.

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 6.6 above. For any unsupported borrowing taken out in support of strategic priorities or for 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 that MRP is calculated using Option 3 where this is deemed to be appropriate. This will mean that trading services would not be put at an unfair disadvantage in comparison to any potential competitors.

In addition revised accountancy guidelines to comply with IFRS are to be introduced for 2010/2011. The new standards will potentially have

the effect of reclassifying operational leases, finance leases and PFI contracts. These proposed changes may affect a number of the Council's prudential indicators. In particular, changes to accounting standards for PFI schemes and leasing may require these assets to be brought onto the Council's balance sheet adjusting previous years' MRP repayments. It is recommended that the MRP policy for both 2009/2010 and 2010/2011 be adjusted in accordance with section 6.8 c) below and monitored to ensure that there will be no impact on council taxpayers from revisions to accounting standards.

6.8 In summary, it is recommended that the Council approves the following Annual Minimum Revenue Provision Statement for both 2009/2010 and 2010/2011:

- a) For all government supported borrowing the Council will adopt Option 1 as set out in the government's guidance which is a continuation of the basis upon which the Council currently calculates MRP.
- b) For all unsupported borrowing the Council will adopt Option 3 and make MRP repayments using the equal instalment method with the estimated useful life of an asset being assessed by the Director of Financial Resources in consultation with appropriate officers.
- c) For MRP payments in relation to finance leases and PFI contracts previously held off-balance sheet but now included on-balance sheet to comply with IFRS requirements, the amount of MRP to be made will be set to ensure that the finance charge and MRP for finance leases and on-balance sheet PFI schemes is equal to the rental or service charge payable in the income and expenditure account for the year, which writes down the balance sheet liability of those assets. The Council will therefore follow DCLG guidance which states:

'IFRS requires these changes to be accounted for retrospectively, with the result that an element of the rental or service charge payable in previous years (and previously charged to the revenue accounts) will be taken to the balance sheet to reduce the liability. On its own, this change in the accounting arrangements would result in a one-off increase to the capital financing requirement, and an equal increase in revenue account balances. This is not seen as a prudent course of action, and guidance aims to ensure that authorities are in the same position as if the change had not occurred. It does this by recommending the inclusion in the annual MRP charge of an amount equal to the amount that has been taken to the balance sheet to reduce the liability, including the retrospective element in the first year.'

Following the above DCLG guidance will ensure that, if the impending move to IFRS in local government has the effect of

bringing more PFI schemes and leases on balance sheet, there will be no effect on the charge to the revenue account and no impact on council taxpayers arising from changes made to accounting standards that must be followed by the Council.

- d) The Council will 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 6.6 above, in order to make an increased voluntary MRP where this is considered to be both prudent and affordable. This requirement may be relaxed by the Director of Financial Resources where appropriate, in particular for any unsupported borrowing taken out on behalf of trading services, which are subject to market pressures.

## **7. Treasury Management**

### **7.1 The Revised CIPFA Treasury Management Code of Practice 2009**

In the light of the demise of the Icelandic banks in 2008, CIPFA has responded by amending the CIPFA Treasury Management in the Public Services Code of Practice (the Code) and Cross-Sectoral Guidance Notes, including a revised Treasury Management Policy Statement. It is a requirement of the Code that it should be formally adopted by the Council. The revised code is set out in Appendix E and the Council is asked to adopt the revised Code together with the revised Treasury Management Policy Statement (Appendix F).

The revised Code addresses a number of key areas including the following:

- All Councils must formally adopt the revised Code and four clauses set out in Appendix E;
- The Treasury Management Strategy Statement should affirm that the effective management and control of risk are prime objectives of the Council's treasury management activities;
- The Council's attitude towards risk must be clearly identified within the Treasury Management Strategy Statement which will affirm that priority is given to security of capital and liquidity when investing funds and explain how that will be carried out;
- Responsibility for risk management and control lies with the Council and cannot be delegated to any outside organisation.
- Credit ratings in respect of investment strategy should only be used as a starting point when considering risk. Use should also be made of market data and information, quality financial press, information on government support for banks and the credit ratings of that government support.
- Councils should operate a sound diversification policy in respect of its investments, with high credit quality counterparties and consideration should be given to setting country, sector and group limits.



- Borrowing in advance of need is only to be permissible when there is a clear business case for doing so i.e. in respect of the current capital programme or to finance future debt maturities.
- The main annual treasury management strategy and policy reports must be approved by full Council.
- There needs to be, at a minimum, a mid-year review of treasury management strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved.
- Each Council must delegate the role of scrutiny of treasury management strategy and policies to a specific named body.
- Treasury management performance and policy setting should be subjected to prior scrutiny before full Council approval.
- Members should be provided with access to relevant treasury management training.
- Those charged with governance are also personally responsible for ensuring they have the necessary skills and training in treasury management.
- Responsibility for treasury management activities must be clearly defined within the Council.
- Officers involved in treasury management must be explicitly required to follow Council approved treasury management policies and procedures when making investment and borrowing decisions on behalf of the Council (this will form part of the updated Treasury Management Practices set out in Appendix E (2.1)).

The Treasury Management Strategy Statement has been prepared in accordance with the revised Code. Accordingly, the Council's Treasury Management Strategy (TMS) will be approved annually by the full Council and full Council will receive, as a minimum, a mid-year TMS report and an annual Treasury Management outturn report for the previous year by no later than the 30<sup>th</sup> September of the following year. There will also be quarterly reports to Cabinet and the Audit and Governance Committee. In addition, there will be monitoring reports and regular review by members in both executive and scrutiny functions. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

The Council will adopt the following reporting arrangements in accordance with the requirements of the Code: -

<b>Area of Responsibility</b>	<b>Council/ Committee/ Officer</b>	<b>Frequency</b>
Treasury Management Policy Statement (revised)	Full Council	Adoption of the new code for 2010/2011 and then as required
Treasury Management Strategy / Annual Investment Strategy	Full Council	Annually before the start of the year
Treasury Management Strategy / Annual Investment Strategy – mid year report	Full Council	Mid year
Treasury Management Strategy / Annual Investment Strategy – updates or revisions at other times	Full Council	As appropriate
Annual Treasury Management Outturn Report	Full Council	Annually by 30/9 after the end of the financial year
Treasury Management Monitoring Reports	Director of Financial Resources	Monthly
Treasury Management Practices	Director of Financial Resources	Annually
Scrutiny of Treasury Management Strategy	Cabinet / Audit and Governance Committee	Annually before Full Council
Scrutiny of Treasury Management Performance	Cabinet / Audit and Governance Committee	Quarterly

## **7.2 Treasury Limits for 2010/2011 to 2012/2013 (under the newly revised CIPFA Prudential Code)**

It is a statutory duty under Section 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 prudential indicator P5 at Appendix D and is otherwise known as the Authorised Limit for External Debt.

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' and affordable.

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 the two successive financial years thereafter.

All Treasury Management indicators are included in Appendix D as noted previously in section 5.1.

### **7.3 Revised Investment Guidance**

It should also be noted that CLG is undertaking a consultation exercise on draft revised investment guidance which will result in the issue of amended investment guidance for English local authorities that will come into effect from 1 April 2010. Members will be informed when the guidance has been finalised, indicating any further changes that have been made that require incorporation in the Treasury Management Strategy Statement. It is not currently expected that there will be any major changes required over and above the changes already required by the revised Code and included in the Treasury Management Strategy Statement in Appendix G. However, in order to provide for the possibility of changes being made it is proposed that delegated authority be granted to the Director of Financial Resources to effect any changes necessary.

### **7.4 Treasury Management Strategy for 2010/11**

The Treasury Management Strategy comprises a Borrowing and an Investment Strategy. These set out the Council's policies for managing its borrowing and investments and for giving priority to the security and liquidity of investments. The proposed Treasury Management Strategy Statement is detailed in Appendix G

The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management in the Public Services Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Act and subsequent guidance requires the Council to set out its Treasury Management Strategy for Borrowing and to prepare an Annual Investment Strategy. This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The suggested strategy for 2010/2011 is set out in Appendix G and is based upon the Director of Financial resources' views on interest rates, supplemented with leading market forecasts and other financial data available and advice provided by the Council's treasury adviser, Sector Treasury Services.

**8. Alternative Options**

8.1 No alternatives are submitted for Cabinet consideration.

**9. Background Papers**

Various Notifications regarding Capital Resources for 2010/2011 from Government Departments  
Sector City Watch (Monthly)  
Local Government Act 2003  
The Prudential Code for Capital Finance in Local Authorities (Fully Revised Second Edition)  
Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes (Fully Revised Second Edition 2009)  
Treasury Management in the Public services Guidance Notes for Local Authorities including Police Authorities and Fire Authorities (Fully Revised Third Edition)

## Capital Programme 2010/2011

### Environmental, Protective, and Cultural Services (Other Services)

#### 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 2010/2011 and the outlook for the medium term;
- the need to provide for commitments arising from the 2009/2010 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 2010/2011 capital programme.

#### 2. Resources

##### 2.1 Capital Receipts

The impact of the credit crunch has seen both a significant drop in the market price of developable land, and a withdrawal of market interest in purchasing new land sites. To mitigate this impact the Council has temporarily funded the gap in the funding of the capital programme by utilising earmarked sums within the Strategic Investment Reserve, and has adopted an approach of progressively earmarking resources as part of the final accounts and budget processes to gradually meet the gap in financing the capital programme.

It is intended to continue to seek to address the funding shortfall as the opportunity arises including through capital receipts as these are realised and as other funding opportunities become available.

In line with previous decisions of Cabinet, the position in relation to marketing of sites will be kept under review and sites marketed when appropriate.

##### 2.2 Revenue Budget Savings

In assessing the overall resources available an assessment has been made of the savings which will accrue from a range of sources, including through additional contingency savings, interest and debt

charge savings and allocation of existing budgets for 2009/2010. It is proposed that a sum of £8.192 million will be used from these sources to support the capital programme for 2010/2011.

### **3. Proposed New Starts**

3.1 After taking account of the commitments arising from the 2009/2010 and previous years capital programmes, resources are available to resource the following main schemes / projects at this stage. Schemes / projects are at various stages of development and subject to other processes e.g. external and other funding has yet to be confirmed for some projects, and these schemes / projects will therefore be brought forward for detailed approval when appropriate.

#### **3.2 Blue Bin Recycling Scheme - £300,000**

The Council is introducing a new kerbside collection scheme for recyclable materials. A total of £2.400 million has been allocated towards this scheme for the purchase of bins, however provision is required for a further £0.300 million following receipt of tenders and to make some allowance for lost bins in the early years of operating the revised collection arrangements.

#### **3.3 Disabled Facilities Grants - £570,000**

Disabled Facilities Grants, to support access within the home, amounting to £0.570 million are committed from the Council's revenue funding on an annual basis in addition to specific capital grants and supported borrowing allocations received each year.

#### **3.4 Football Facilities Investment - £1,700,000**

The Football Investment Strategy, presented to Cabinet on 13th January 2010, set out a clear 'vision' for football facilities and the 'player development pathway' in Sunderland, across public, private and school based provision. It established a clear approach to the level of provision including the implementation of local standards for playing fields and ancillary facilities. The Football Investment Strategy provides a framework from which to guide future investment, resources and subsequently increase satisfaction with, and participation in, football and physical activity in the city.

In order to implement the Football Investment Strategy, a £0.700 million Council capital allocation has been provided for from the funding allocated to fund the Strategic Investment Plan to match £1.000 million of 'in principle' funds from the Football Foundation.

#### **3.5 Central Car Park - £1,400,000**

On 9<sup>th</sup> September 2009, Cabinet approved the award of a contract for the demolition of the car park to levels A and B, retaining an operational indoor market throughout and after the works at an estimated scheme cost of £2.900 million. Cabinet recommended approval was given to a commitment of £1.400 million against

2010/2011 capital resources to add to the provision made in the 2009/2010 capital programme of £1.500 million.

**3.6 Economic Development Block Provision - £800,000**

The proposal seeks to continue the policy of providing funding for a range of capital projects and job creation and retention initiatives that support economic development and regeneration objectives in the city. The fund provides a resource to deal with unforeseen demands. It covers both strategic investments in infrastructure and facilities for business and direct support to business growth and investment activities.

**3.7 Economic Development Support Provision - £3,000,000**

Funding has been earmarked to support major economic development initiatives in conjunction with other bodies, including the Regional Development Agency, the government and the private sector. Further details will be submitted to Cabinet with the definitive proposals.

**3.8 Strategic Land Acquisition - £4,000,000**

It is proposed to earmark resources to support opportunity acquisitions of land and buildings assets in accordance with the recently agreed Land Acquisition Policy. It is proposed that this is funded from prudential borrowing where one-off resources are unavailable.

**3.9 Seafront - £1,848,000**

The Council has been successful in bidding for £1.000 million CABE Sea Change funding to refurbish and remodel Marine Walk at Roker. This followed extensive public consultation on the Seafront Strategy. The grant award requires matched funding of £0.500 million. In addition funding is provisionally earmarked as follows:

- £168,000 contributions from Area Committees to address public realm improvements at the seafront at Seaburn
- £120,000 is available from the 2008/2009 Highways Maintenance Budget.
- £60,000 is anticipated to be available from capital receipts associated with this scheme.

It is proposed to utilise these sums to refurbish and enhance the facilities of the Seafront Toilets. In addition, an ongoing revenue budget provision of £12,000 has been made to secure the opening of the Seafront toilets on a year round basis.

**3.10 Houghton Primary Care Centre - £2,400,000**

This project will provide a physical link with Houghton Sports Centre and a new build Wellness Centre, café and support facilities. Total capital development cost for the project is estimated to be £21.653 million. It is proposed that the Council contribute £2.400 million resources towards this project (£2.000 million from resources available to finance new starts in 2010/2011 and £0.400 million from prudential borrowing in 2011/2012). The prudential borrowing will be funded on an 'invest to save' basis through increased leisure income.

**3.11 City Centre Customer Service Centre - £150,000**

The proposed project for the further development of the Civic Centre Customer Service Centre reception for visitors is aimed at rationalising the existing customer service facilities at the civic centre, provide a better utilisation of staff resource, increasing the security for staff working at Civic Centre complex, and improve customer, staff and Member satisfaction.

**3.12 Automated Court Bundle System - £30,000**

Currently the production of court bundles is completed manually for delivery to judges, courts, barristers and other parties. These typically can run to hundreds of pages. An electronic system will allow all case documents to be scanned, securely stored, ordered, paginated and updated as cases progress. Moving from a manual to an electronic system will allow for more efficient and effective use of staff time in bundle preparation and provision, and in accessing archived cases and will substantially reduce future storage requirements. At this stage, pending an evaluation of the efficiency savings arising, it is proposed to earmark the sum of £30,000. It is anticipated that this will be funded on an 'invest to save' basis with a limited payback period.

**3.13 City Centre - £1,000,000**

It is proposed to continue to provide a sum of £1.000 million to support projects to generate outputs and outcomes quickly and clearly demonstrate the Council's support for the growth and vitality of the City Centre and the businesses that operate within it.

Proposed schemes will be brought forward for 2010/2011 with the aim being to meet the objectives of;

- growing the city centre economy with the underlying objective of creating more jobs and improving the offer to Sunderland residents and visitors;
- demonstrating our commitment to the public realm and the environment within the city centre to grow and develop the business community's confidence and encourage private sector investment in the city centre;
- increase the number of users and visitors to the city centre with a view to increasing spend in the city centre increase the profitability of businesses based in the city centre which should lead to expansion of existing businesses.

Whilst no definitive proposals are made as part of this report, proposals will be brought forward over the next couple of months and are likely to include:

- Festivals and Events;
- Street Scene Improvements;
- Marketing and Promotion;
- Business Support.



An evaluation is currently being undertaken of the projects which have been delivered this year and this will be used to inform any proposals for a programme of projects to be delivered during 2010/2011.

**3.14 CISCO Call Manager System Replacement - £491,000**

The current CISCO telephony system was installed six years ago. The data network underpinning the system is becoming unreliable and requires replacement to allow integration with the Council VOIP system and to enable efficiencies through better use of more up to date telephony solutions, economies of scale and reduced maintenance costs.

**3.15 Other Issues**

Resources have been provisionally allocated as a capital contingency to schemes relating to a number of outline infrastructure schemes which it is intended, will be brought forward on an invest to save or income generating basis, and where external and other funding remains to be confirmed. With regard to the invest to save and income generating schemes, it is anticipated that funding for these schemes will be met through prudential borrowing, subject to the consideration of the individual business cases.

3.16 In considering this area of the programme, the latest allocations of Single Programme funding for specific schemes have been incorporated. Taking account of the latest revised allocations of funding from the government, and the latest guidance from government regarding the determination of priorities, the Regional Development Agency has confirmed its intentions to fund specific schemes up to the end of 2010/2011. This has resulted in some schemes being ineligible for funding, including the Cultural Interpretation Centre Scheme. Accordingly a review is being undertaken, taking account of the objectives of the scheme, so that a revised proposal, or proposals can be brought forward for inclusion in the capital programme.



**Capital Programme 2010/2011  
Children's Services, Adult Services, Highways and Housing**

**1. Introduction**

- 1.1 Consideration has been given to the overall resource position facing the Council in respect of the Children's, Adults, Highways and Housing elements of the Capital Programme.

The following paragraphs set out the major proposed schemes, projects and areas for investment for inclusion in the 2010/2011 capital programme in these four areas.

**2. Children's Services**

**2.1 Primary Strategy for Change (PSfC)**

Following approval of the Primary Strategy for Change (PSfC), funding of £10,562,786 has been secured from the Department for Children Schools and Families (DCSF) to replace St Joseph's Primary School and Maplewood Special School. These schools were identified during the PSfC consultation process as initial priorities.

- 2.2 The future capital programme for Children's Services is very much influenced by the outcome of the PSfC Programme and the School Place Planning Review. As a consequence, future available resources are being allocated / redirected as appropriate to support these initiatives.

**2.3 Modernisation Programme**

A key medium term priority for Children's Services continues to be that of addressing the most urgent condition priorities, health and safety work, and major capital repairs as identified through the asset management process.

**2.4 Targeted Capital for Schools Kitchen and Dining Facilities**

Specific funding has been received from the DCSF to enable local authorities to increase lunch take up by building or refurbishing school kitchens and improving dining areas and facilities. Refurbishment of 6 primary schools kitchen and dining facilities will take place in 2010/2011.

**2.5 Youth Capital Fund**

The specific aim of the Youth Capital Fund is to provide a discrete capital budget to be spent on young people led projects to respond to young people's needs.

**2.6 Early Years Foundation Stage**

This funding has been allocated through the government's Sure Start Early Years and Childcare Grant to support the improvement of the

quality of the learning environment in early years settings and to ensure that that all children have access to the provision. Total funding of £2,858,460 had been provided for the period 2008/2009 to 2010/2011. The final tranche of £952,820 has been allocated for 2010/2011.

### 3. Adult Services

#### 3.1 IT Infrastructure

Specific grants for information technology investments are allocated by the Department for Health to all local authorities with Adult Social Care responsibilities. It is proposed that these specific grants are used to deliver the Directorate ICT roadmap, which feeds into the Directorate's 3 year Delivery Plan. More specifically, it is proposed that the grants of £0.113 million are used to support the mobile and lone worker solution which is estimated to cost £0.250 million. This project will support the property rationalisation agenda which will ensure workers are safe and can access council systems. The balance of funding of £0.137 million will be from the 2010/2011 Adults Revenue Budget in the form of a Revenue Contribution to Capital.

#### 3.2 Mental Health

A range of schemes are proposed to be funded from the Mental Health specific capital grant. Schemes aimed at improving service provision, rationalising office accommodation, and enabling mobile and flexible working are estimated to cost £0.110 million and in addition £0.050 million is proposed to be allocated to developments at Herrington Park Café.

#### 3.3 Minor Works

Minor Works are funded from a capital grant of £0.146 million from the Department of Health and £0.105 million from the 2010/2011 Adults Revenue Budget in the form of a Revenue Contribution to Capital. The proposed refurbishments for 2010/2011 are detailed below:

	<b>£'000</b>
Cassaton House moves	20
25 Hepburn Grove	32
Nook Lodge	16
2-4 Swaledale Crescent	10
Washington Multi Purpose Centre	30
Bishopwearmouth Nursery	23
The Close	16
St Marks Garage	14
Leechmere Training Centre	18
ILC Air-conditioning	16
210 Grindon Lane	33
2 Blackwood Road	15
Works less than £10,000	8
<b>Total minor works 2010/2011</b>	<b>251</b>

## **4. Highways**

### **4.1 Sunderland Strategic Transport Corridor (SSTC) Phase 2**

At its meeting on 9<sup>th</sup> September 2009, Cabinet agreed to proceed with the development of the SSTC Phase 2 to include a landmark bridge. The project is included in the capital programme at an estimated cost of £133.068 million funded from the Department for Transport (DfT), One North East and the City Council. Expenditure of £3.890 million is planned for 2010/2011.

### **4.2 Central Route**

The development of the scheme and progress on land issues prior to programme entry approval from the DfT will continue in 2010/2011 in respect of which expenditure of £0.668 million is proposed.

### **4.3 Local Transport Plan (LTP)**

The DfT allocation for 2010/2011 amounting to £8.577 million is the final year of the 5 year LTP Programme. It includes an integrated transport element of £3.544 million in the form of a capital grant, an amount of £4.729 million in the form of SCE(R) for maintenance and £0.304 million capital grant for bridge maintenance schemes at the A1018 Bridge Street Subway; A1018 Dane Dorothy Subway and A1018 Stockton Road/Cowan Terrace Bridges.

The following use of funding is proposed for 2010/2011:

- complete the Structural Maintenance of the Four Lane Ends Bridge on the A690 and Grange Road Bridge on the A1231;
- carry out the Pallion Road / Trimdon Street Bridge Maintenance Scheme;
- continue the bus corridor improvements feasibility study and commence the first phase of this programme at the Wheatsheaf and Stadium Way junctions;
- continue with the Major Scheme Business Case for the SSTC Phase 3;
- continue with the Structural Maintenance of Highways across the city;
- carry out a programme of works to improve road safety and access;
- reduce congestion and improve cycling facilities across the city;
- contribution to funding of the SSTC Phase 2;
- contribution to funding for the Southern Radial Route;
- contribution to the development costs of the Central Route.

## **5. Housing**

- 5.1 The Strategic Housing Investment Pot (SHIP) funding is allocated through the Regional Housing Board. It is anticipated that £1.491 million will be available to support new schemes in 2010/2011. This allocation is indicative only as final approvals have not yet been announced. The allocation of £1.864 million in 2009/2010 has been

reduced when assessing the 2010/21011 programme as early indications suggest a 20% cut in funding as funds are diverted from existing stock refurbishment to new builds. In addition, further grant funding from the CLG specifically for Disabled Facilities Grants is yet to be announced but is included at this stage, at this year's level of £1.006 million.

The following projects are provisionally proposed for inclusion in the 2010/2011 capital programme:

**5.2 Disabled Facilities Grant**

Disabled Facilities Grants have specific allocations through SHIP (£0.381 million indicative allocation), CLG DFG Grant (£1.006 million for 2009/2010 - the allocation for 2010/2011 to be confirmed) and a Council contribution funded by a revenue contribution to capital (£0.570 million) amounting to £1.957 million.

**5.3 Housing Renovation Loans Scheme**

The Loans Scheme is funded via SHIP under objective 3 for decent homes. Grant funding of £0.240 million (indicative allocation) is expected which will be used to finance the loan scheme.

**5.4 Warm Homes Initiative**

An indicative allocation of £0.080 million is proposed to be allocated to energy efficiency measures, such as loft insulation and cavity wall insulation, enabling those in need of support to maintain their independence in their chosen home for the foreseeable future. The funding is used to help lever in external funding. In addition, a contingency of £50,000 will be made available should this funding be considered insufficient.

**5.5 Area Renewal and Private Sector Renewal**

An indicative allocation of £0.790 million from the SHIP allocation is proposed to support decent homes and market rejuvenation initiatives. Area renewal supported by the SHIP is taking place in the Eppleton, Castletown and Hendon areas of the city.

**Prudential Code Indicators 2010/2011 to 2012/2013**

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.

It should be noted that accounting regulations relating to the introduction of International Financial Reporting Standards (IFRS) are being introduced that may affect a number of the Council's prudential indicators. In particular, changes to accounting standards for PFI schemes and leasing may require these assets to be brought onto the Council's balance sheet, increasing the Council's capital financing requirement, authorised limit for external debt and operational boundary for external debt. These adjustments are technical in nature and authorities are being consulted on the measures required. A prudent amount has been added to all limits to reflect these potential adjustments, however as guidance has not yet been finalised should any of the Council's prudential indicators be exceeded as a result these changes they will be reported to Cabinet and where appropriate full Council at the next meetings following the change.

The indicators that must be taken into account are shown below:

- P1 Actual capital expenditure incurred in 2008/2009 was £123.531 million and the estimates of capital expenditure to be incurred for the current and future years that are recommended for approval are:

Portfolio	Estimated Capital Expenditure			
	2009/10 £'000	2010/11 £'000	2011/12 £'000	2012/13 £'000
Leader / Deputy Leader Resources	1,195	3,800	0	0
Children & Learning City	55,106	21,410	17,122	11,277
Healthy City	7,750	3,748	2,681	2,786
Attractive & Inclusive City	25,836	22,458	15,919	38,633
Sustainable Communities	5,002	6,163	790	790
Prosperous City	2,363	13,274	1,547	0
Responsive Services & Customer Care	1,595	2,676	400	0
Safer Cities	487	1,425	0	0
Contingencies (including provisions for prudential borrowing and schemes subject to further evaluation and approval)	0	11,614	8,800	50,800
<b>TOTAL</b>	<b>104,625</b>	<b>87,835</b>	<b>47,464</b>	<b>104,286</b>

An estimate has been made of future spend on the basis of grants expected to be received in 2010/2011 onwards. Where no formal grant offer has been received for anticipated capital schemes, such as Building Schools for the Future Wave 2, a provision has been made within the Contingencies section in the capital programme detailed above. 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 2008/2009 are:

Ratio of financing costs to net revenue stream				
2008/2009	2009/2010	2010/2011	2011/2012	2012/2013
Actual	Estimate	Estimate	Estimate	Estimate
2.28%	4.20%	4.83%	5.29%	5.53%

The estimates of financing costs include current commitments and the proposals in the revenue budget and capital programme reports. The forecasts show an anticipated decrease in the ratios of financing costs to net revenue stream than those previously reported in 2008/2009 and 2009/2010 due to the Council achieving a higher than anticipated rate of return on investments in 2008/2009 and through the incorporation of previously excluded general grants such as Area Based Grant in the calculation of the indicator.

The indicators show an increase in anticipated ratios in future years and reflects the fact that significant amounts of expenditure are



planned to be financed from earmarked reserves which will lead to investment levels decreasing over time and also due to forecasted low levels of interest rates as a result of the economic downturn, the end of which is uncertain. It should be noted that the ratios will vary depending on the interest rate obtained on investments and the level of investments available. If there is, for example, slippage in use of grants used to fund the capital programme then the ratios shown in the table above will decrease, whilst any reduction in the interest rate obtained on investments, beyond that estimated, will lead to an increase in the reported ratios.

As detailed in section 6.8 of the main report, there are planned voluntary increases to the statutory Minimum Revenue Provision in order that, in relation to non-trading areas, 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 2010/2011.

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 31st March 2009 are:

<b>Capital Financing Requirement</b>				
<b>31/03/09</b>	<b>31/03/10</b>	<b>31/03/11</b>	<b>31/03/12</b>	<b>31/03/13</b>
<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>Actual</b>	<b>Estimate</b>	<b>Estimate</b>	<b>Estimate</b>	<b>Estimate</b>
205,781	294,927	307,627	315,968	320,974

The Capital Financing Requirement measures the authority's underlying need to borrow for a capital purpose. In accordance with best 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 cash flows 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 substantial increase in the Capital Financing Requirement at 31/03/10 reflects potential changes arising from compliance with new accounting standards relating to IFRS (these are detailed in section 5.2 of the main report).

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 2008/2009, 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 2010/2011.

The Council's net borrowing at 31<sup>st</sup> March 2009 was £10.094 million and as noted in Prudential Indicator P7 the Council's actual external borrowing was £169.092 million. This variation between actual and net borrowing reflects the cash flow position of the authority and balances held in earmarked reserves. The gap will reduce over time as earmarked reserves are used to fund specific projects.

The benefits of having a high level of investments are that:

- a larger amount of interest will be received that can then be used to help support Council budgets and help deliver strategic plans;
- the Council has greater freedom in making its borrowing decisions and can take out borrowing when the timing is right rather than being potentially subject to market volatility; and,
- the liquidity risk is reduced as having a high level of investments means that in the short term the Council is less at risk should money market funds dry up.

The risks associated with holding a high level of investments are:

- from a reduced level of interest earned to that budgeted for should interest rates reduce; and,
- the risk of counterparties not repaying money the Council invests with them.

The Council has mitigated these risks by having a risk averse Treasury Management Investment Strategy and by detailed monitoring of counterparties through its borrowing and investment strategies and treasury management working practices and procedures.

- 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 Director of Financial Resources, 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 Cabinet and the Council at their next meetings following the change.

	<b>Authorised Limit for External Debt</b>			
	<b>2009/2010</b>	<b>2010/2011</b>	<b>2011/2012</b>	<b>2012/2013</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
Borrowing	331,759	323,990	323,990	328,447
Other long term liabilities	1,563	91,558	93,053	94,548
<b>Total</b>	<b>333,322</b>	<b>415,548</b>	<b>417,043</b>	<b>422,995</b>

The Director of Financial Resources 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 Director of Financial Resources 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 for the Council. A specific element of risk has also been taken into account for these bodies.

In taking its decisions on the Revenue Budget and Capital Programme for 2010/2011, the Council is asked to note that the authorised limit determined for 2010/2011, (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 Director of Financial Resources, 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 a report will be made to Cabinet and Council if it is exceeded at any point. In any financial year, it is generally 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. It is considered likely that the Council's set operational boundary for 2009/2010 of £227.212 million will be exceeded as a result of accounting changes relating to the incorporation of IFRS requirements and Cabinet is asked to recommend a revision in the Council's operational boundary for external debt in 2009/2010 to £292.481 million in the light of these changes.

	<b>Operational Boundary for External Debt</b>			
	<b>2009/10</b>	<b>2010/11</b>	<b>2011/12</b>	<b>2012/13</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
Borrowing	200,918	235,743	246,126	256,109
Other long term liabilities	91,563	91,558	93,053	94,548
<b>Total</b>	<b>292,481</b>	<b>327,301</b>	<b>339,179</b>	<b>350,657</b>

P7 The Council's actual external debt at 31<sup>st</sup> March 2009 was £169.092 million.

The Council includes an element for long-term liabilities relating to PFI schemes and finance leases in its calculation of the operational and authorised boundaries to allow further 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 any 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:

<b>For Band D Council Tax</b>		
<b>2010/2011</b>	<b>2011/2012</b>	<b>2012/2013</b>
£0.98	£4.51	£6.95

The estimates show the net revenue effect of all capital expenditure from all schemes commencing in 2010/2011 and the following two financial years. The impact on the Band D Council Tax detailed above takes account of estimated government grant funding through General Grants.

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 £8.21 in 2013/2014. 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 The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This original 2001 Code was adopted on 20<sup>th</sup> November 2002 by full Council and the revised Code (see Appendix E in this report) will be adopted on 3<sup>rd</sup> March 2010.

The objective of the Prudential Code is to provide a clear 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.

**CIPFA Treasury Management in the Public Services Code of Practice - Indicators 2010/2011 to 2012/2013**

- P10 It is recommended that the Council sets an upper limit on its fixed interest rate exposures of £90 million in 2010/2011, £115 million in 2011/2012 and £120 million in 2012/2013.
- P11 It is further recommended that the Council sets an upper limit on its variable interest rate exposures of £50 million in 2010/2011, £60 million in 2011/2012 and £60 million in 2012/2013.
- 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 expressed as a percentage of total projected borrowing that is fixed rate at the start of the period:

	<b>Upper limit</b>	<b>Lower limit</b>
Under 12 months	40%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	75%	0%
5 years and within 10 years	100%	0%
10 years and within 20 years	100%	0%
20 years and within 30 years	100%	0%
30 years and within 40 years	100%	0%
40 years and within 50 years	100%	0%
over 50 years	100%	0%

- P13 A maximum maturity limit of £100 million is set for each financial year (2010/2011, 2011/2012 and 2012/2013) 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 G).

At present the Council has £36.525 million of long-term investments. The main element of this is £35.000 million in term deposits, of which £30.000 million matures in 2010/2011 and £5.000 million matures in 2011/2012. The remaining £1.505 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 £0.020 million in government securities, other shares and unit trusts.

## Adoption of the revised CIPFA Treasury Management Code of Practice 2009

### 1. INTRODUCTION

- 1.1 The CIPFA Code of Practice on Treasury Management in Local Authorities was revised in 2009 in the light of the default on investments to Icelandic banks in 2008. The revised Code requires that a report be submitted to the Council, board or other appropriate body, setting out four amended clauses which should be formally passed in order to approve adoption of the new version of the Code of Practice and Cross-Sectoral Guidance Notes.
- 1.2 The revised Code also includes an amended version of the Treasury Management Policy Statement (TMPS) incorporating a revised definition of treasury management activities (please see Appendix F). The Code sets out various requirements, incorporated into the Treasury Management Strategy Statement, which have been summarised in section 7.1 of the report

### 2. RESOLUTIONS

- 2.1 CIPFA recommends that all public service organisations adopt, as part of their standing orders, financial regulations, or other formal policy documents appropriate to their circumstances, the following four clauses.
1. The Council will create and maintain, as the cornerstones for effective treasury management:
    - a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities;
    - suitable Treasury Management Practices (TMP's), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities These will cover the following Treasury Management activities:
      - TMP1 Risk management;
      - TMP2 Performance management;
      - TMP3 Decision making and analysis;
      - TMP4 Approved instruments, methods and techniques;
      - TMP5 Organisation, clarity and segregation of responsibilities, and dealing arrangements;
      - TMP6 Reporting arrangements and management information arrangements;
      - TMP7 Budgeting, accounting and audit arrangements;
      - TMP8 Cash and cash flow management;
      - TMP9 Money laundering;
      - TMP10 Training and qualifications;

- TMP11 Use of external service providers;
- TMP12 Corporate governance.

The content of the policy statement and TMP's will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation deviating from the Code's key principles.

2. The Council will receive reports on treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMP's.
3. The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and for the execution and administration of treasury management decisions to the Director of Financial Resources, who will act in accordance with the organisation's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.
4. The Council nominates the Audit and Governance Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.



## Treasury Management Policy Statement

CIPFA recommends that the Council's Treasury Management Policy Statement adopts the following form of words to define the policies and objectives of its treasury management activities:

- The Council defines its treasury management activities as: The management of the Council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".
- The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.
- The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

The Council is requested to formally approve this statement.



## **Treasury Management Strategy Statement**

### **1. Introduction**

- 1.1 The Council has customarily considered an Annual Treasury Management Strategy Statement under the requirement of the CIPFA Code of Practice on Treasury Management, adopted by the Council on 20<sup>th</sup> 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, including the development of an integrated Treasury Management Strategy.
- 1.2 The revised CIPFA Treasury Management in the Public Services Code of Practice and Prudential Code still require due regard to be had to the Prudential Indicators set out in Appendix D, when determining the Council's Treasury Management Strategy.

### **Borrowing Strategy**

- 1.3 The suggested borrowing strategy for 2010/2011 in respect of the following aspects of the treasury management function is based upon the Director of Financial Resources' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser. The strategy covers:
- the past and current treasury position including interest rates;
  - the borrowing requirement for 2010/2011;
  - an economic forecast, including the outlook for interest rates;
  - capital borrowings and borrowing strategy for 2010/2011;
  - debt rescheduling.

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

### **Annual Investment Strategy**

- 1.4 The Annual Investment Strategy comprises:
- investment objectives;
  - security of capital: the use of credit ratings and other market intelligence;
  - investments defined as capital expenditure;
  - provision for credit related losses;
  - past performance and current position;
  - outlook and proposed investment strategy for 2010/2011;
  - end of year report.

The Annual Investment Strategy is set out at paragraphs 7 to 14.

## **BORROWING STRATEGY**

### **2. The Past and Current Treasury Position including Interest Rates**

#### **2.1 Interest Rates 2009/2010**

- 2.1.1 Interest rates have varied only slightly during the current financial year, with the largest movement being in the 10 year period which has moved up 0.88%. Both the shorter and the longer periods show a slight decrease from the start of the year, as shown in the table below:

<b>Loan Type</b>	<b>31<sup>st</sup> March 2009 %</b>	<b>20<sup>th</sup> January 2010 %</b>	<b>Difference %</b>
7 Day Notice	0.50	0.25	(0.25)
1 Month	0.96	0.41	(0.55)
PWLB - 1 Year	0.83	0.93	0.10
5 Year	2.56	3.13	0.57
10 Years	3.38	4.26	0.88
25 Years	4.28	4.57	0.29
50 Years	4.58	4.49	(0.09)

The Bank of England Base Rate was reduced from 1.00% to 0.50% on 5<sup>th</sup> March 2009 where it has remained.

- 2.1.2 Shorter-term interest rates –The Bank of England is expected to resist increasing the Base Rate for as long as possible to help build up momentum in economic growth for the UK. It is forecast to increase by 0.25% in September 2010 and end the financial year at 1.50%. The risk to this scenario is judged to be that these projected increases will be delayed.
- 2.1.3 Longer-term interest rates – Public Works Loan Board (PWLB) rates have remained relatively flat throughout 2009/2010. The 1 year PWLB has remained around 1%, while the 25 year and 50 year have hovered around 4.50%.

#### **2.2 Long-term Borrowing 2009/2010**

- 2.2.1 As part of the Treasury Management Policy and Strategy Statement, which was included in the March 2009 Capital Programme report to Council, a benchmark rate of 4.00% was set for all long-term borrowing to be undertaken in 2009/2010.
- 2.2.2 Long-term borrowing of £5.6 million was required to be replaced in 2008/2009 as a result of 11.75% redeemable stock maturing in November 2008. As PWLB rates were forecast to fall during 2009/2010, a decision was taken not to replace this borrowing at that time.

The Council had a further possible borrowing requirement of £20.0 million due to four 'Lenders Option Borrowers Option' loans (LOBO's)

that were due to rollover in 2009/2010 (details shown below). With a LOBO the lender has the option to vary the rate on the rollover date and the Council can either accept the new rate or repay the loan. The lenders have not exercised their option to vary the rate in respect of these loans so far in 2009/2010, and these loans will continue to the next rollover period.

Start Date	Lender	Amount £m	Period (Years)	Rate %	Rollover Date	Rollover Period
29/09/06	Dexia	5.0	60	4.32	29/09/09	Every 3 Years
21/10/03	Barclays	5.0	40	4.50	21/10/09	Every 6 Months
03/02/06	Dexia	5.0	60	4.37	03/02/10	Every 3 Years
22/02/06	Dexia	5.0	60	4.38	22/02/10	Every 3 Years

2.2.3 The Treasury Management Strategy for 2009/2010 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".

In January 2009, £30.0 million of PWLB loans (with an average rate of 4.20%) were prematurely repaid as part of a debt rescheduling exercise. This was considered opportune as investment rates were averaging 1.80% (and were projected to fall further as the Bank Base Rate was cut to help protect the economy from the recession). Investments were therefore used to temporarily finance this transaction as the net premium involved was very advantageous, being almost cost neutral. The aim was then to replace the loans in 2009/2010 in a range of tranches at various maturity periods over the short to medium term to mitigate against any interest rate risk in the future. All replacement loans were taken out with regard to the Council's target borrowing rate of 4% or below, thus reducing the overall interest charged to the Council.

These loans have now been replaced and are shown in the table below:

Date	Lender	Loan No	Amount £'m	Period (Years)	Rate %	Difference from Benchmark of 4%
18/06/09	PWLB	495591	5.0	3.0	2.32	1.68
18/06/09	PWLB	495595	5.0	4.0	2.73	1.27
22/06/09	PWLB	495612	5.0	9.0	3.67	0.33
30/06/09	PWLB	495648	5.0	10.0	3.71	0.29
10/08/09	PWLB	495784	4.0	8.5	3.65	0.35
10/08/09	PWLB	495785	4.0	11.5	3.99	0.01
13/10/09	PWLB	496090	2.0	18.5	3.99	0.01
<b>Total</b>			<b>30.0</b>			
13/10/09	PWLB	496090	3.0	18.5	3.99	0.01
<b>Total Borrowed</b>			<b>33.0</b>			

The £33 million replacement borrowing from the PWLB was at an average rate of 3.414%.

A total of £30 million of these loans (with an average rate of 3.356%) were to replace the £30 million of PWLB that was prematurely repaid at an average rate of 4.2%. This will result in annual savings of £252,200 per annum for at least the next 3 years.

The remaining £3 million borrowed (at 3.99%) was to partly replace the £5.6m 11.75% stock which matured in November 2008 and this will result in annual savings of £232,800.

Interest rates will continue to be monitored to determine the optimum time to replace the remaining £2.6 million loan stock with new PWLB borrowings.

On 12<sup>th</sup> January 2010 a further rescheduling exercise was undertaken when £24.0 million of PWLB loans with an average rate of 4.2% were prematurely repaid, which was almost cost neutral, incurring a minimal cost of £288. These loans are shown below:

Date	Lender	Loan No	Amount £m	Period (Years)	Rate %	Premium / (Discount) £
12/01/10	PWLB	490872	4.0	45.0	4.15	(46,699)
12/01/10	PWLB	490873	4.0	46.0	4.15	(47,065)
12/01/10	PWLB	491674	3.0	46.0	4.20	(5,908)
12/01/10	PWLB	491675	3.0	47.0	4.20	0
12/01/10	PWLB	491676	3.0	48.0	4.20	0
12/01/10	PWLB	491695	3.0	48.0	4.30	60,144
12/01/10	PWLB	491876	4.0	47.0	4.25	39,816
<b>Total Repaid</b>			<b>24.0</b>			<b>288</b>

This action was considered opportune as investment rates were averaging 0.8% and the average interest payable on the PWLB loans was on average 4.2%, it was therefore considered prudent and appropriate to repay certain higher interest rated PWLB loans using investments to temporarily finance this transaction as the net premium involved was very advantageous, being almost cost neutral. This will result in annual savings of £817,000. The aim is then to replace the loans in 2010/2011 or in future years by replacing the debt on a lower term or with variable rate debt prior to securing lower long term rates at some point in the future, depending upon the financial market outlook.

It is intended to temporarily fund the loans repaid by the use of investments as the current return on investments is much lower than the 4.2% interest that was being paid on these loans.

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.

- 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 (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. The rescheduling of these LOBO's had the following effects:
- Lengthening the period of the loan resulting in a lower interest rate;
  - 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 23<sup>rd</sup> April 2007.

Start Date	Lender	Amount £m	Period (Years)	Rate %	Fixed Period	Roll Over Period
21/10/03	Barclays	5.0	40	4.5	23/04/07	Every 6 months

The last 'roll-over' date (21<sup>st</sup> October 2009) 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 22<sup>nd</sup> January 2010 is:

		Principa (£m)	Total (£m)	Average Rate (%)
<b>Borrowing</b>				
Fixed Rate Funding	PWLB	107.5		
	Market	24.5		
	Other	0.4	132.4	3.95
Variable Rate Funding	PWLB	0.0		
	Market	15.0		
	Temporary/ Other	30.9	45.9	1.70
<b>Total Borrowing</b>			<b>178.3</b>	<b>3.37</b>
<b>Total Investments</b>	In House		<b>164.3</b>	<b>1.93</b>
<b>Net Debt</b>			<b>14.0</b>	

This Council currently has a difference between gross debt and net debt (after deducting cash balances), of £14.0 million.

- 2.4 There are a number of risks and benefits associated with having both a large amount of debt whilst at the same time having a considerable amount of investments.

Benefits of having a high level of Investments are;

- liquidity risk – having a large amount of investments means that the Council is less at risk should money markets become restricted or less available.- this mitigates against liquidity risk;
- interest is received on investments which helps the Council to address its Strategic Priorities;
- the Council has greater freedom in the timing of its borrowing as it can afford to wait until the timing is right rather than be subject to the need to borrow at a time when interest rates are not advantageous.

Risks associated with holding a high level of Investments are;

- the Counterparty risk – institutions can not repay the Council investment placed with them;
- interest rate risk – the rate of interest earned on the investments will be less than that paid on debt, thus causing a loss to the Council.

The Council has mitigated these risks by formulating its Treasury Management Policy that incorporates both a Borrowing Strategy and an Annual Investment Strategy and has also taken prudent action to redeem debt early using investments temporarily to the benefit of the Council by saving on interest charges particularly over the past two financial years.

### 3. Borrowing Requirement 2010/2011

#### 3.1 Future Borrowing Requirement

		2010/11 £m	2011/12 £m	2012/13 £m
1.	Unsupported Capital Borrowing (potential)	14.0	10.0	10.0
2.	Replacement borrowing (PWLB)	26.5	0.0	5.0
3.	Replacement borrowing (Market)	0.0	0.0	0.0
4.	Market LOBO replacement (potential)	10.0	19.5	20.0
<b>TOTAL – KNOWN (2+3)</b>		<b>26.5</b>	<b>19.5</b>	<b>25.0</b>
<b>TOTAL – POTENTIAL (1+4)</b>		<b>24.0</b>	<b>29.5</b>	<b>35.0</b>

### 4. The Outlook for Interest Rates

- 4.1 The Council has appointed Sector Treasury Services as treasury advisers to the Council and part of their service is to assist the Council to formulate a view on interest rates.



## 4.2 Economic Forecasts

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.

### 4.2.1 Survey of Economic Forecasts

The table below shows the HM Treasury – December 2009 summary of forecasts of 23 City and 12 academic analysts for Q4 2009 and Q4 2010. Forecasts for 2010 to 2013 are based on 31 forecasts in the last quarterly forecast (January 2010):

Bank Rate Forecast	Quarter ended			Annual Average Bank Rate			
	Actual	Q4 2009	Q4 2010	Average 2010	Average 2011	Average 2012	Average 2013
	%	%	%	%	%	%	%
<b>Median</b>	0.50	0.50	1.30	0.70	1.80	3.00	3.70
<b>Highest</b>	0.50	0.50	2.00	1.30	3.30	4.30	4.60
<b>Lowest</b>	0.50	0.50	0.50	0.50	0.50	1.00	1.40

4.2.2 Sector's interest rate forecast of 11<sup>th</sup> January 2010 is set out below:

	2009/10	2010/11				2011/12				2012/13			
	Mar 2010 %	Jun 2010 %	Sept 2010 %	Dec 2010 %	Mar 2011 %	Jun 2011 %	Sept 2011 %	Dec 2011 %	Mar 2012 %	Jun 2012 %	Sept 2012 %	Dec 2012 %	Mar 2013 %
<b>Bank Rate</b>	0.50	0.50	0.75	1.00	1.50	2.25	2.75	3.25	3.50	3.75	4.25	4.25	4.50
<b>PWLB 5yr</b>	3.05	3.20	3.30	3.40	3.60	3.85	4.15	4.55	4.60	4.80	4.80	4.85	4.85
<b>PWLB 10 yr</b>	4.00	4.05	4.15	4.30	4.45	4.60	4.80	4.90	5.00	5.10	5.10	5.15	5.15
<b>PWLB 25y</b>	4.55	4.65	4.70	4.80	4.90	5.00	5.05	5.10	5.20	5.30	5.30	5.35	5.35
<b>PWLB 50yr</b>	4.60	4.70	4.75	4.90	5.00	5.10	5.15	5.20	5.30	5.40	5.40	5.45	5.45

4.2.3 Capital Economics interest rate forecast of 5<sup>th</sup> November 2009 is set out below

	2009/10	2010/11				2011/12		
	Mar 2010 %	Jun 2010 %	Sept 2010 %	Dec 2010 %	Mar 2011 %	Jun 2011 %	Sept 2011 %	Dec 2011 %
<b>Bank Rate</b>	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
<b>PWLB 5yr</b>	2.35	2.15	2.15	2.15	2.15	2.15	2.15	2.15
<b>PWLB 10 yr</b>	3.45	3.15	2.65	2.65	2.65	2.65	2.65	2.65
<b>PWLB 25y</b>	3.85	3.75	3.75	3.75	3.75	3.75	3.75	3.75
<b>PWLB 50yr</b>	4.15	4.05	4.05	4.05	4.05	4.05	4.05	4.05

4.2.4 UBS interest rate forecast of January 2010 is set out below

	2009/10	2010/11				2011/12		
	Mar 2010 %	Jun 2010 %	Sept 2010 %	Dec 2010 %	Mar 2011 %	Jun 2011 %	Sept 2011 %	Dec 2011 %
Bank Rate	0.50	0.50	0.75	1.00	1.50	2.00	2.50	3.00
PWLB 5yr	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
PWLB 10 yr	3.90	4.05	4.40	4.75	4.90	5.15	5.40	5.40
PWLB 25y	4.45	4.65	5.00	5.15	5.40	5.65	5.90	5.90
PWLB 50yr	4.55	4.75	5.10	5.25	5.50	5.75	6.00	6.00

### 4.3 Economic Background

#### 4.3.1 Introduction

- The global credit crunch, of August 2007 almost led to the near collapse of the world banking system in September 2008. This then had the effect of pushing most of the major economies of the world into a very sharp recession in 2009, which was accompanied by a dearth of lending from banks anxious to rebuild their weakened balance sheets. Many governments were forced to recapitalise and rescue their major banks with the consequence that most central banks around the world agreed to cut their central bank rates to between 0.10% – 1.00% in order to help counter the ensuing world recession.
- The long awaited start of growth eventually came through in quarter 3 of 2009 in the US and the EU. However, there was disappointment that the UK failed to emerge from recession until quarter 4. Figures released on 26<sup>th</sup> January 2010 showed that the UK emerged from the recession in Quarter 4 of 2009, but only by the slenderest of margins, by 0.1%. This shows that the recovery is still quite fragile.
- Inflation has plunged in most major economies and is currently not seen as being a problem for at least the next two years due to the large output gaps and high unemployment which will have the effect of curbing wage growth. In many countries there have been widespread pay freezes in 2009 and these are likely to be persistent for some time.
- Most analysts think that there still needs to be a radical world rebalancing of excess savings rates by cash rich Asian and oil based economies and excess consumption rates in Western economies if the world financial system is to avoid a potential repeat of this type of financial crisis in the future.
- Most major economies have resorted to an expansion of fiscal stimulus packages in order to encourage a quicker exit from

recession. This, together with expenditure on direct support provided to ailing banks, has led to a significant increase in government debt levels which will take many years to repay.

#### 4.3.2 **Two growth scenarios**

- The main issue with the world economy at the moment is 'how quickly will the major world economies recover' however opinion by financial experts and economists is divided as detailed below: This division of opinion is also reflected in the views of Capital Economics and UBS in the tables above which set out their views on interest rates projected into the future..

#### 4.3.3 **Strong recovery**

- This is a normal cyclical recovery which will be strong in the major world economies. The US still has potential to add further fiscal stimulus in 2010 to ensure that strong recovery continues after the current round of stimulus measures end. Growth in the EU is likely to be strong in 2010 and is likely to not require such help from EU governments.
- The forecast suggests that UK GDP growth will almost get back to the long term average of about 2.5% by 2011 but growth is likely to peak in the first half of 2010 as inventory rebuilding and stimulus measures begin to fade and some fiscal contraction occurs later in the year.
- In addition it is suggested that the economy will rebalance with strong growth in exports and import substitution helped by strong recovery in the EU and the rest of the world.
- Sterling has depreciated by 25% since reaching its peak in 2007 and is expected to remain weak, which benefits manufacturing industry and exports.
- Consumer spending – only a minimal recovery is expected due to a steady increase in the savings ratio from +5.6% in 2009 to about +8% in 2011 as consumers reduce debt and/or build up cash savings. Consumer spending will also be low due to the fact that both earnings/incomes will be held down by pay freezes or below inflation increases and increases expected in general taxation.
- House price recovery is expected to persist helped by a low Bank Base Rate for a prolonged period. House prices are expected to rise by about 6% in 2010, and 3% in 2011. Mortgage approvals are anticipated to rise back to the level of around 75,000-80,000 per month and this scale of increase is needed to ensure a continuation of a trend of rising house prices.
- CPI inflation was expected to peak at 2.5% in early 2010 after the rise in VAT in January but then to fall to a low of roughly 1.5% in early 2011 and to stay below 2% for the rest of 2011.
- The current MPC attitude is one of restraint and seeking to avoid increasing Bank Base rates for as long as possible to secure economic recovery, the aim being to try to ensure that growth is achieved and well established before Bank Base rates gets back to the level of 4%–5% before the next cyclical recession and that all assets purchased through Quantitative Easing measures have

been sold off by then. The first Bank Base Rate increase is expected in Q3 2010.

- A change of Government in 2010 with a more aggressive fiscal stance could delay the timing of Bank Base Rate increases.
- The UK fiscal deficit is 6.4% of GDP, about £90bn, which is expected to fall at £11bn per annum, over the next eight years at currently planned rates. This is similar to the peak deficit of 7% experienced in the 1990s which was remedied to a surplus of 1.6% in the space of 6 years helped by strong, steady economic growth of 3% per annum and supported by loose government monetary policy that compensated for the fiscal squeeze.

The major risk to this scenario would be a lack of supply of bank credit. However, it is felt that the Bank of England is on alert to ensure that this does not happen and would continue various measures to assist the expansion of credit.

#### **4.3.4 Weak Recovery**

- The current economic cycle is not a normal business cycle but a balance sheet driven cycle. Over borrowing by banks, corporates and consumers are focused on shrinking their levels of borrowing to more viable and affordable levels and this balance sheet adjustment will take several years to effect. Repayment of debt will therefore act as a major impetus to the required increase in demand in the economy. Consequently, there will only be weak economic recovery over the next few years after the initial sharp inventory rebuilding and is forecast to reach only 1.5% maximum growth by 2011.
- Fiscal contraction will further dampen economic recovery driven by a strong political agenda to accelerate cuts in government and public expenditure together with increases in taxation expected after the general election in 2010.
- The consumer savings ratio will rise so as to eliminate over borrowing and to insure against people losing their jobs during the present economic downturn. This will depress consumer expenditure which is the main driver of the UK economy thus limiting expected growth.
- Growth will also be hampered by a reduced supply of credit from weakened banks compounded by weak demand for credit.
- The eventual reversal of Quantitative Easing will take cash out of the economy and further reduce demand in the economy.
- Unemployment is likely to rise to near 3 million in 2010 and take some years to subside due to expected weak growth. High unemployment will reduce tax income and increase expenditure on benefits and the costs of local authority services.
- Inflation will not be a threat for several years as the current 6% output gap will take until 2014 to be corrected.
- However, deflation is considered a risk for some years to come as both falls in manufacturing prices over the last 12 -18 months and the impact of wage deflation will still have to feed through to the economy.

- CPI inflation will rise up to over 2% in early 2010 but will then be on a strong downward trend to about -1% in 2011.
- There is no need for the MPC to change the Bank Base Rate from 0.5% in 2010 or 2011 and possibly for the next 5 years as they will need to counter the fiscal contraction that will dampen demand in the economy over this period.
- Long term PWLB rates will fall from current levels to nearer 4% in 2010 due to the weak economic recovery and minimal inflation highlighted above so that the real rate of return (net of inflation) on long dated gilts is considered appropriate at these low levels

#### **4.3.5 Economic summary and review**

- At the current time it is difficult to have confidence as to exactly how strong the UK economic recovery will prove to be. Both the above scenarios are founded on large conflicting assumptions and research.
- The Council's treasury advisers have adopted a more moderate view between these two scenarios which is reflected in the economic forecast set out in 4.2.2. and is based upon the following views:
  - The risk that long-term gilt yields and PWLB rates will rise markedly are considered high.
  - There are large uncertainties in both scenarios due to the major difficulties of forecasting the following areas:
    - degree of speed and severity of fiscal contraction after the general election;
    - timing and amounts of the reversal of Quantitative Easing;
    - speed of recovery of banks' profitability and balance sheet imbalances;
    - changes in the consumer savings ratio;
    - rebalancing of the UK economy towards exporting and substituting imports.

In summary, the overall balance of risks is weighted to the downside, with the view that the pace of economic growth disappoints and Bank Rate increases are delayed and / or lower than presently forecast.

There is also a risk that a double dip recession could occur.

#### **4.4 Base Rate Forecast**

Sector has advised that they expect the Bank Base Rate to steadily increase over the next three financial years from its current level of 0.50% to 1.50% by March 2011 and to 4.50% by March 2013.

#### **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 steadily increase throughout 2010/2011 across all periods. The 5 years PWLB is forecast to be 3.6% by March 2011 and the 25 year and 50 year to be around the 5.0% mark.

## **5. Capital Borrowings and Borrowing Strategy for 2010/2011**

**5.1** Money markets will no doubt become more volatile in the lead up to the General Election. The Director of Financial Resources 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**

**5.2.1** The main sensitivities of the forecast are likely to be the two scenarios below. Council officers, in conjunction with 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 considered.

The Director of Financial Resources, taking account of the advice of the Council's treasury adviser considers a benchmark financing rate of 4.50% for any further long-term borrowing for 2010/2011 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 2009/2010.

**5.2.2** If long term rates do not fall then consideration will be given to utilising some investment balances to fund the borrowing requirement in 2010/2011. In addition, the Council may not need to borrow further depending upon the evaluation and progress 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 Director of Financial Resources, taking advice from the Council's treasury advisers will continue to monitor rates closely, and whilst implementing 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 of debt will include:

- the generation of cash savings at minimum risk;
- in order to help fulfil the Treasury Management 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. However, changes to the PWLB rules in 2007, in respect of replacement loans significantly impacted upon the potential for debt rescheduling unless significant changes in interest rates are forecast or occur. Such has been the case in the latter part of 2008 and in 2009.

The latest interest rate projections for 2010/2011 show short term borrowing rates will be considerably cheaper than longer term rates. As such there are likely to be significant opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of their short term nature and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio. Any such rescheduling and repayment of debt is likely to lead to a reduction in volatility in the Council's maturity profile as in recent years there has been a skew towards longer dated PWLB. The Council is keeping a watching brief on market conditions in order to secure further early debt redemption when, and if, appropriate opportunities arise. 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.

6.2 There has been much discussion as to whether the size of spread between long term PWLB repayment and new borrowing rates should be revised (downwards) in order to help local authorities currently dissuaded from using investment cash balances to repay long term borrowing and thereby reduce counterparty and interest rate risk exposure. This has also been highlighted in recent government consultations which emphasise that Councils must not borrow to on-lend and in a recent Debt Management Office (DMO) / PWLB consultation document options were suggested to revise the methodology used to calculate the early repayment rate. The consultation period ended in January 2010 and developments will be monitored to assess if there is any merit in amending the strategy if significant changes are introduced.

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

## ANNUAL INVESTMENT STRATEGY

### 7. Introduction

- 7.1 The 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 Completion of an Annual Investment Strategy is a requirement under the Government's Guidance on Local Government Investments. The Annual Investment Strategy states which investments the Council may use for the prudent management of its treasury balances during the financial year under the headings 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 are for greater than one year (up to a maximum of 5 years), this can present a higher risk than investments for shorter periods.
- 7.3 This Strategy sets out:
- the procedures for determining the use of each class of investment (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 class of investment;
  - the amount or percentage limit to be invested in each class of investment;
  - 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 the Council is the prudent investment of its treasury balances. The Council's investment priorities are in order of importance:
- (A) The **security** of capital;
  - (B) The **liquidity** of its investments and then
  - (C) The Council aims to achieve the **optimum yield** on its investments but this is commensurate with the proper levels of security and liquidity.



## **9. Security of Capital: The Use of Credit Ratings**

### **9.1 Sovereign Credit Ratings**

One of the recommendations of the Code is that local authorities set limits for the amounts of investments that can be placed with institutions based in foreign countries. Previously investment criteria was based upon the individual credit ratings for institutions. It is therefore recommended that sovereign ratings are applied in the Council's Counterparty criteria as set out in Appendix H.

### **9.2 Counterparty Criteria and Other Market Intelligence and Information**

The Council takes into account not only the credit ratings issued by all three credit rating agencies (Fitch, Moody's and Standard & Poor's), but also, all available market data and intelligence, the level of government support to financial institutions and advice from its Treasury Management advisors and has done so for many years.

Set out in Appendix H is the detailed criteria that will be used, subject to approval, in determining the level of investments that can be invested with each counterparty or institution. Where a counterparty is rated differently by any of the 3 rating agencies, the lowest rating will be used to determine the level of investment.

### **9.3 Monitoring of Credit Ratings:**

- All credit ratings are monitored on a daily basis. The Council has access to all three credit ratings agencies and is alerted to changes through its use of the Sector Treasury Services credit worthiness service.
- If a counterparty's rating is downgraded with the result that it no longer meets the Council's minimum criteria, the Council will cease to place funds with that counterparty. The Council will also immediately inform its external fund manager(s), if used, to cease placing funds with that counterparty.
- If a counterparty's rating is downgraded with the result that, their rating is still sufficient for the counterparty to remain on the Approved Lending List, then the counterparty's authorised investment limit will be reviewed accordingly. A downgraded credit rating may result in the lowering of the counterparty's investment limit and vice versa. The Council will also immediately inform its external fund manager(s), if used, of any such 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.

## **9.4 Post Credit Crunch Developments**

Since the credit crunch crisis there have been a number of developments which require separate consideration and which also help inform the Annual Investment Strategy.

### **9.4.1 Nationalised / Part Nationalised Banks**

In order to stabilise the UK banking system, the UK Government nationalised some banks (Northern Rock and Bradford & Bingley) and took a major shareholding in others (Royal Bank of Scotland (RBS - 84% stake) and Lloyds (43% stake)). These investments by the Government will be managed on a commercial basis by a new arm's-length company, 'UK Financial Investments Limited' (UKFI), which is wholly owned by the Government. Its overarching objectives will be to protect and create value for the taxpayer as shareholder, with due regard to financial stability and acting in a way that promotes competition.

On 1<sup>st</sup> January 2010 Northern Rock was split into two separate entities; Northern Rock Plc and Northern Rock Asset Management. Northern Rock Plc is the "good bank", according to the Government, and will be regulated by the FSA. It is this bank which will hold local authority deposits. Previously Fitch assigned an Individual Rating of F to Northern Rock, which reflected that this bank had failed and is now owned by the Government. However, since the split of the bank on 1<sup>st</sup> January 2010 Fitch have not issued an individual or support rating and are currently reviewing their ratings in relation to Northern Rock.

The Government by taking such a large stake in RBS and Lloyds, together with the support packages listed below, have demonstrated their determination not to let these banks fail. As a result of this the Governments AAA rating will be applied to these counterparties with a counterparty limit of £40 million in line with our the credit criteria set out in Appendix H.

### **9.4.2 UK Banking System - Support Packages**

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 eight named banks with a £500bn support package. Whilst no blanket guarantee is in place this represented a very significant financial commitment which has been accompanied by further statements of intent should a worsening scenario emerge. It is proposed to continue to lend to these eight banks and building societies within the UK, applying a credit rating of AA to these counterparties in recognition of their participation in the Governments support package. As a result of this it is proposed to apply to these counterparties a counterparty limit of £30 million in line with our credit criteria set out in Appendix H

On 13<sup>th</sup> October 2008, the UK Government announced a further measure known as the Credit Guarantee Scheme. This scheme forms part of the Government's measures announced on 8th October 2008 to ensure the stability of the financial system and to protect savers, depositors, businesses and borrowers. In summary these measures are intended to:

- provide sufficient liquidity in the short term;
- make available new capital to UK banks and building societies to strengthen their resources, permitting them to restructure their finances, while maintaining their support for the real economy; and,
- ensure that the banking system has the funds necessary to maintain lending in the medium term.

As previously stated this Credit Guarantee Scheme is not a blanket guarantee by the UK Government on all deposits but it has underlined the Government's determination to ensure the security of the UK banking system by supporting the banking system with a £500bn support package.

In April 2009 the government introduced its Asset-backed Securities Guarantee Scheme. The assets eligible for the 2009 Scheme will be residential mortgage-backed securities (RMBS) backed by residential mortgages over property in the UK. HM Treasury will keep the scope of the 2009 Scheme under review. The 2009 Scheme forms part of the Government's measures, announced on 19 January 2009, to support lending in the UK economy, and represents an extension of the 2008 Credit Guarantee Scheme for unsecured debt issuance by UK incorporated banks and building societies (the "2008 Scheme").

In summary, the 2009 Scheme is intended to:

- improve banks' and building societies' access to wholesale funding markets
- help support lending to creditworthy borrowers
- promote robust and sustainable markets over the long term
- protect the taxpayer.

#### **9.4.3 Other Countries**

Other countries have also signalled their support for their domestic banks through the provision of very significant financial support and guarantees similar to those provided by the UK Government in relation to its banks.

#### **9.4.4 Sovereign Ratings**

The sovereign credit rating of a particular country would take precedence over the individual credit ratings for the banks covered by that guarantee. However a judgement is necessary as to whether to rely on the blanket guarantees to authorise lending to these banks and for which countries they are prepared to do so. The Council,

after consultation with its Treasury Advisers have decided to only to include countries with a minimum sovereign credit rating of AA+. Furthermore, when determining which country to include, other information will be considered such as the Gross Domestic Product (GDP) for that country as well as its economic outlook, and the strength of its financial system.

## **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 have to be funded out of capital or revenue resources and are 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 in accordance with proper accounting practice or any prevailing government regulations, if applicable.

## **12. Past Performance and Current Position**

**12.1** During 2009/2010 the Council did not employ any external fund managers, all funds being managed by the in-house team.

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

	<b>2008/09 Return %</b>	<b>2008/09 Benchmark %</b>	<b>2009/10 Return %</b>	<b>2009/10 Benchmark %</b>
			<b>Year to date</b>	<b>Year to date</b>
Council	5.06	3.60	1.90	0.35

**12.2** During 2009/2010 the Council will continue to review the optimum arrangements for the investment of its funds.

### **13. Outlook and Proposed Investment Strategy 2010/2011**

- 13.1** Based on its cash flow forecasts, the Council anticipates its fund balances in 2010/2011 are likely to range between £150 million and £230 million which represents a cautious approach and provides for funding being received in excess of the level budgeted for and also for unexpected and unplanned levels of slippage and underspending. However in 2010/2011, 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 or used for debt rescheduling. 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 2010/2011, (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 £50 million. As the Council has decided to restrict most of its investments to term deposits, it will maintain liquidity by having a minimum of 40% of these short-term investments maturing within 6 months.
- 13.5** A maximum limit of £100 million is to be set for in-house non-specified investments over 364 days up to a maximum period of 2 years. This amount has been calculated by reference to the Council's cash flows, including the potential use of earmarked reserves. The Director of Financial Resources 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 any 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 interest bearing accounts and will follow the criteria as set out in Appendix H.
- 13.7** The Director of Financial Resources, in conjunction with the Council's treasury adviser Sector Treasury Services, and taking into account the minimum amount to be maintained in short-term investments will

continue to monitor investment rates closely and to identify any appropriate investment opportunities that may 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 I);
- they will be allowed to invest in term deposits, Certificates of Deposit (CD's) and government gilt securities;
- An investment limit of £3 million per institution (per manager);
- A maximum limit of 50% fund exposure to government gilts;
- 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 I) and also with reference to the Lending List Criteria set out in (Appendix H).

**13.10** It is further proposed that:

- Delegated authority continue to be given to the Director of Financial Resources, in consultation with the Cabinet Portfolio holder for Resources, to vary the Lending List Criteria and Lending List itself should circumstances dictate, on the basis that changes be reported to Cabinet retrospectively, in accordance with normal Treasury Management reporting procedures.

#### **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.

## LENDING LIST CRITERIA

### Counterparty Criteria

The Council takes into account not only the individual institution's credit ratings issued by all three credit rating agencies (Fitch, Moody's and Standard & Poor's), but also all available market data and intelligence, the level of government support and advice from its Treasury Management advisors.

Set out below are the criteria to be used in determining the level of funds that can be invested with each institution. Where an institution is rated differently by the rating agencies, the lowest rating will determine the level of investment.

<b>Fitch / S&amp;P's Long Term Rating</b>	<b>Fitch Short Term Rating</b>	<b>S&amp;P's Short Term Rating</b>	<b>Moody's Long Term Rating</b>	<b>Moody's Short Term Rating</b>	<b><u>Maximum Deposit £m</u></b>	<b><u>Maximum Duration</u></b>
AAA	F1+	A1+	Aaa	P-1	40	2 Years
AA+	F1+	A1+	Aa1	P-1	40	2 Years
AA	F1+	A1+	Aa2	P-1	30	364 days
AA-	F1+ / F1	A1+ / A-1	Aa3	P-1	20	364 days
A+	F1	A-1	A1	P-1	10	364 days
A	F1 / F2	A-1 / A-2	A2	P-1 / P-2	10	364 days
A-	F1 / F2	A-2	A3	P-1 / P-2	5	6 months
Local Authorities (limit for each local authority)					30	364 Days

Where the UK Government holds a shareholding in an institution the UK Government's credit rating of AAA will be applied to that institution to determine the amount the Council can place with that institution.

The Code of Practice for Treasury Management in the Public Services recommends that consideration should also be given to country, sector, and group limits in addition to the individual limits set out above, these new limits are as follows:

## Country Limit

At present, only UK institutions are included on the Council's approved Lending List. It is proposed that only countries with a minimum sovereign credit rating of AA+ by all three rating agencies will be considered for inclusion on the Approved Lending List.

It is also proposed to set a limit of £30 million for all countries except for the UK provided they meet the above criteria. A separate limit of £250 million will be applied to the United Kingdom and is based on the fact that the government has done and is willing to take action to protect the UK banking system.

Country	Limit £m
UK	250
Non UK	30

## Sector Limit

The Code recommends a limit be set for each sector in which the Council can place investments. These limits are set out below:

Sector	Limit £m
Central Government	250
Local Government	250
UK Banks	250
UK Building Societies	150
Foreign Banks	0

## Group Limit

Where institutions are part of a group of companies e.g. Lloyds Banking Group, Santander and RBS, then total limit of investments that can be placed with that group of companies will be determined by the highest credit rating of a counterparty within that group, unless the government rating has been applied.

This will apply provided that:

- the government's guarantee scheme is still in place;
- the UK continues to have a sovereign credit rating of AAA; and
- that market intelligence and professional advice is taken into account.

Current group limits are set out in Appendix I.



Approved Lending List

Appendix I

	Fitch				Moody's			Standard & Poor's		Limit £m	Max Deposit Period
	L Term	S Term	Individual	Support	L Term	S Term	Fin Strength Rating	L Term	S Term		
<b>UK</b>	AAA	F1+			Aaa			AAA		250	364 days
<b>Lloyds Banking Group</b> (see Note 1)										<b>Group Limit 40</b>	
Lloyds Banking Group plc	AA-	F1+	C	1	A1	-	-	A	A-1	40	364 days
Lloyds TSB Bank Plc	AA-	F1+	C	1	Aa3	P-1	C-	A+	A-1	40	364 days
Bank of Scotland Plc	AA-	F1+	C	1	Aa3	P-1	D+	A+	A-1	40	364 days
<b>Royal Bank of Scotland Group</b> (See Note 1)										<b>Group Limit 40</b>	
Royal Bank of Scotland Group plc	AA-	F1+	D/E	1	A1	-	-	A	A-1	40	364 days
The Royal Bank of Scotland Plc	AA-	F1+	D/E	1	Aa3	P-1	C-	A+	A-1	40	364 days
National Westminster Bank Plc	AA-	F1+	-	1	Aa3	P-1	C-	A+	A-1	40	364 days
Ulster Bank Ltd	A+	F1+	E	1	A2	P-1	D-	A	A-1	40	364 days
<b>Santander Group *</b>										<b>Group Limit 30</b>	
Santander UK plc	AA-	F1+	B	1	Aa3	P-1	C-	AA	A-1+	30	364 days
Abbey National Treasury Services plc	AA-	F1+	-	-	Aa3	P-1	-	-	-	30	364 days
Alliance and Leicester plc	AA-	F1+	B	1	Aa3	P-1	E+	AA	A-1+	30	364 days
Barclays Bank plc *	AA-	F1+	B	1	Aa3	P-1	C	AA-	A-1+	30	364 days
HSBC Bank plc *	AA	F1+	B	1	Aa2	P-1	C+	AA	A-1+	30	364 days
Nationwide BS *	AA-	F1+	B	1	Aa3	P-1	C-	A+	A-1	30	364 days
Standard Chartered Bank *	A+	F1	B	1	A2	P-1	C+	A+	A-1	30	364 days
Clydesdale Bank / Yorkshire Bank **	AA-	F1+	C	1	A1	P-1	C-	A+	A-1	10	364 days
Co-Operative Bank Plc	A-	F2	B/C	3	A2	P-1	D+	-	-	5	6 months
Northern Rock	A+	-	-	-	-	-	-	A	A-1	10	364 days

	Fitch				Moody's			Standard & Poor's		£m Limit	Max Deposit Period
	L Term	S Term	Individual	Support	L Term	S Term	Fin Strength Rating	L Term	S Term		
<b>Top 10 Building Societies (by asset size)</b>											
Nationwide BS (see above)											
Yorkshire BS	A-	F2	B/C	3	Baa1	P-2	D+	A-	A-2	0	
Coventry BS	A	F1	B	3	A3	P-2	C-	-	-	5	6 Months
Chelsea BS ***	BBB+	F2	C	3	Baa3	P-3	E+	-	-	0	
Skipton BS	A-	F2	B/C	3	Baa1	P-2	D+	-	-	0	
Leeds BS	A	F1	B/C	3	A2	P-1	C+	-	-	10	364 Days
West Bromwich BS ***	BBB-	F3	C/D	3	Baa3	P-3	E+	-	-	0	
Principality BS ***	BBB+	F2	C	3	Baa2	P-2	D-	-	-	0	
Newcastle BS ***	BBB-	F3	C/D	3	Baa2	P-2	D-	-	-	0	
Norwich and Peterborough BS ***	BBB+	F2	C	3	Baa2	P-2	D	-	-	0	

## Notes

### Note 1

Nationalised / Part Nationalised

The counterparties in this section will have the UK Government's AAA rating applied to them thus giving them a credit limit of £40 million for a maximum period of 364 days

\* Banks / Building Societies which are part of the UK Government's Credit Guarantee scheme

The counterparties in this section will have a AA rating applied to them thus giving them a credit limit of £30 million for a maximum period of 364 days

\*\* The Clydesdale Bank (under the UK section) is owned by National Australia Bank

\*\*\* These will be revisited and used only if they meet the minimum criteria (ratings of A- and above)

Any bank which is incorporated in the United Kingdom and controlled by the FSA is classed as a UK bank for the purposes of the Approved Lending List