**TYNE & WEAR FIRE AND RESCUE AUTHORITY**

**MEETING: 23RD FEBRUARY 2009**

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**SUBJECT: CAPITAL PROGRAMME 2009/2010 INCLUDING PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT STRATEGY**

**JOINT REPORT OF THE CHIEF FIRE OFFICER, CLERK TO THE AUTHORITY, FINANCE OFFICER AND THE CHIEF EMERGENCY PLANNING OFFICER**

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## 1. Introduction

1.1 The purpose of this report is to present for consideration and approval of Members, the Capital Programme for 2009/2010, the Prudential Indicators, and the Treasury Management Strategy for 2009/2010.

## 2. Capital Resources

2.1 The Authority receives grant support towards borrowing costs through the Revenue Support Grant (RSG) Settlement. The Authority is also able to supplement the capital programme with:-

- the ‘usable’ part of any capital receipt;
- a contribution from revenue resources;
- supported capital expenditure;
- specific capital grant
- operating leases.

## 3. Capital Programme 2009/2010

3.1 Since the 2008/2009 Capital Programme was reported to Members on 19th January 2009, the capital requirements of the Authority for 2009/2010 have been reviewed by the Chief Fire Officer, through the Authority’s Asset Management Group.

**Commitments from 2008/2009**

3.2 Commitments, in terms of slippage from 2008/2009 to 2009/2010, have been included in the 2009/2010 Capital Programme, as previously reported to Members. The slippage is already funded as part of the Capital Programme 2008/2009 and the consequential adjustments to financing will be made as part of the final accounts process for 2008/2009.

**New Starts**

3.3 The Capital Programme for 2009/2010 includes provision of £1,143,200 to fund New Starts. The proposed Capital Programme and Vehicle Replacement Programme for 2009/2010 are attached at Appendix A. Included within New Starts is provision for the following capital schemes:

- IT Equipment (£550,000) – includes a hardware refresh of the Authority's IT network, which will result in improved resilience and reliability, and will provide opportunities to reduce its carbon footprint by reducing the number of servers. This should, in turn, lead to efficiency savings from 2010/2011 onwards;
- Operational Equipment (£443,200) – includes the replacement of Breathing Apparatus throughout the fleet, providing the most up to date safety equipment for firefighters. Provision is also included for the purchase of thermal imaging cameras;
- Works from Stock Condition Survey (£100,000) – following surveys, a number of prioritised works have been identified to assist with the long-term maintenance of the Authority's non-PFI estate. Works will be undertaken on a prioritised basis over the next three to five years;
- Other schemes less than £100,000 (50,000) – minor works, including at the Brigade Training Centre and Wallsend Fire Station.

**Resourcing**

3.4 The Capital Programme for 2009/2010 of £2,109,986 (including £1,143,200 in respect of New Starts) is resourced as follows:

- Revenue Contribution to Capital Outlay - £1,910,223
- Fire Capital Grant - £199,763
- Borrowing - nil

With regard to the Vehicle Replacement Programme, option appraisal will be undertaken, where leasing finance is available, to determine whether leasing or borrowing represents the best option on a value for money basis. Appropriate budget provision has been included within the Revenue Budget for 2009/2010.

**Future Years**

3.5 Appendix A also includes an indicative Capital Programme for 2010/2011 and 2011/2012. As referred to at paragraph 3.1, the Chief Fire Officer has already undertaken a review of the capital requirements for 2009/2010 and will carry out a similar review of the requirements for 2010/2011 and 2011/2012. This review will ensure that the Authority's investment in its assets delivers best value for money, which is, if possible, particularly important given the current economic outlook. Further updates will be provided to Members through the normal quarterly monitoring process.

## 4. Fire Capital Grant

4.1 As reported previously to Members, this Authority will receive a Fire Capital Grant allocation of £745,323 in 2009/2010 and £959,579 in 2010/2011. This grant represents new money and will not involve borrowing. With the exception of a requirement that the capital grant only be used for capital expenditure, the grant is not ringfenced.

4.2 Paragraph 3.4 identifies that £199,763 of the 2009/2010 Fire Capital Grant is required to contribute towards funding the 2009/2010 Capital Programme. The remainder of the grant will be transferred to a Capital Grants Reserve in order to meet the cost of future prioritised capital schemes.

## 5. Prudential Framework for Local Authority Capital Expenditure

5.1 One of the principal features of the Local Government Act 2003 was to provide the primary legislative requirements to introduce a new 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 which has been published by the Chartered Institute of Public Finance and Accountancy (CIPFA).

5.2 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 revenue support. The basic principle is that authorities are free to invest as long as their capital spending plans are affordable, sustainable and prudent. As a control mechanism, to ensure this occurs, all authorities must follow the Prudential Code published by CIPFA. This involves setting various prudential limits and indicators that must be approved by the Authority 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, where appropriate, reports on the indicators will be made to the Authority as part of the quarterly capital review reports.

5.3 At this stage, it is not necessary to utilise the opportunities within the framework since the Authority is able to afford its capital programme through the use of Revenue Contributions to fund Capital Expenditure.

## 6. The Prudential Indicators

6.1 The prudential indicators, which must be set, are detailed at Appendix B together with background to the indicators and what they are seeking to address. In setting or revising the required indicators, the Authority must have regard to a number of matters:

- affordability e.g. implications for the precept;
- prudence and sustainability;
- implications for external borrowing;
- value for money e.g. option appraisal;
- stewardship of assets e.g. asset management planning;
- service objectives and strategic planning;
- practicality, e.g. achievability of the planned capital investment.

6.2 To aid transparency, wherever possible, indicators for previous years are based on information contained in the published Balance Sheet of the Authority. The Code does not include any suggested limits or ratios, as these will depend on each Authority's circumstances. The indicators are not designed to make comparisons between Authorities.

6.3 In order to ensure that the Authority is in a position to set its prudential indicators for 2009/2010, the preparation of the Capital Programme for 2009/2010 has required estimates of capital expenditure to be prepared over a three year period through to 2011/2012.

## 7. The Annual Minimum Revenue Provision Statement

7.1 Regulations came into force on 31st March 2008 revoking secondary legislation relating to the requirement to make a Minimum Revenue Provision (MRP) to repay borrowing over time, and replacing it 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 (CLG) has provided statutory guidance on the methodology to use, which local authorities 'must have regard to'.

7.2 The guidance recommends that authorities must submit to the full Authority 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 the guidance will be followed.

7.3 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.
- 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.

7.4 For 2009/2010, having considered all of the options available, it is proposed that the Authority uses Option 1 (the regulatory method) for government supported borrowing. This is a continuation of the method previously used by the Authority (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 Authority'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 therefore better reflects the actual funding provided by government.

7.5 The draft regulations also recommend consideration of two options for any future borrowing under the prudential system for which no government support is being given and is therefore self-financed. The Authority currently has no plans to undertake unsupported borrowing and, therefore at this stage, it is not proposed to include a proposed policy in relation to this category of borrowing.

7.6 In summary, it is recommended that the Authority approves the following Annual Minimum Revenue Provision Statement for 2009/2010:

- For all government supported borrowing the Authority will adopt Option 1 as set out in the government's guidance, which is a continuation of the basis upon which the Authority currently calculates MRP as set out in paragraph 7.4 above.

## 8. Treasury Management

8.1 In accordance with the Authority's Financial Regulations, all investment and borrowing is made on the Authority's behalf by Sunderland City Council. This ensures that the Fire and Rescue Authority benefits from beneficial interest rates achieved through pooling resources.

8.2 The Treasury Management Strategy is a joint strategy with that of Sunderland City Council as cash balances, although accounted for separately, are pooled for the purposes of minimising borrowing costs and maximising investment returns.

8.3 Attached for approval at Appendices C and D are the Treasury Management Policy Statement and the detailed Treasury Management Strategy respectively.

## 9. Recommendations

9.1 Members are requested to:

- approve the Capital Programme and Vehicle Replacement Programme for the year 2009/2010 as set out at Appendix A;
- approve the Prudential Indicators for the years 2009/2010, 2010/2011 and 2011/2012 as set out in Appendix B;
- note the Treasury Management Policy set out at Appendix C;
- approve the Treasury Management Strategy for 2009/2010 set out at Appendix D;
- approve the Annual Minimum Revenue Provision Statement set out in Section 6.

Appendix A

# TYNE AND WEAR FIRE AND RESCUE AUTHORITY

# CAPITAL PROGRAMME 2009/2010 TO 2011/2012

**SUMMARY**

| Project Description | Gross Cost | Expenditure to 31.3.09 | Estimated Payments | | |
|---|---|---|---|---|---|
| | | | 2009/10 | 2010/11 | 2011/12 |
| | £ | £ | £ | £ | £ |
| **FIRE SERVICE** | | | | | |
| Continuing Projects | 2,302,156 | 1,300,370 | 966,786 | 0 | 35,000 |
| Projects Commencing 2009/2010 and Future Years | 3,507,200 | 0 | 1,143,200 | 1,400,000 | 964,000 |
| | 5,809,356 | 1,300,370 | 2,109,986 | 1,400,000 | 999,000 |
| **EMERGENCY PLANNING** | 0 | 0 | 0 | 0 | 0 |
| | 5,809,356 | 1,300,370 | 2,109,986 | 1,400,000 | 999,000 |
| **VEHICLE REPLACEMENT PROGRAMME** | | | | | |
| Fire Services-Vehicles | 6,080,000 | 0 | 2,992,000 | 1,544,500 | 1,543,500 |
| **TOTAL CAPITAL EXPENDITURE** | 11,889,356 | 1,300,370 | 5,101,986 | 2,944,500 | 2,542,500 |

## TYNE AND WEAR FIRE AND RESCUE AUTHORITY

## CAPITAL PROGRAMME 2009/2010 TO 2011/2012

| Project Description | Gross Cost | Expenditure to 31.3.09 | Estimated Payments | | |
|---|---|---|---|---|---|
| | | | 2009/10 | 2010/11 | 2011/12 |
| | £ | £ | £ | £ | £ |
| **Continuing Projects** | | | | | |
| **Operational Equipment** | | | | | |
| Fireground Radios | 180,000 | 160,000 | 20,000 | 0 | 0 |
| **Estates** | | | | | |
| Safetyworks | 389,306 | 229,306 | 160,000 | 0 | 0 |
| Station Refurbishment Programme (Birtley, Gosforth, Fulwell, South Division HQ and North Division HQ) | 434,325 | 412,609 | 21,716 | 0 | 0 |
| BTC - Security Improvements and Incident Management Training Facilities | 885,933 | 399,455 | 486,478 | 0 | 0 |
| BTC - Repairs to Fire Ground and Offices | 185,000 | 7,000 | 143,000 | 0 | 35,000 |
| Other schemes (less than £100,000) | 227,592 | 92,000 | 135,592 | 0 | 0 |
| | 2,302,156 | 1,300,370 | 966,786 | 0 | 35,000 |
| **Projects Commencing 2009/2010 and Future Years** | | | | | |
| **IT Equipment** | | | | | |
| IT Equipment | 1,250,000 | 0 | 550,000 | 350,000 | 350,000 |
| **Operational Equipment** | | | | | |
| Operational Equipment | 662,200 | 0 | 443,200 | 80,000 | 139,000 |
| **Estates** | | | | | |
| Works arising from Stock Condition Survey | 300,000 | 0 | 100,000 | 150,000 | 50,000 |
| West Denton - General refurbishment/decoration | 300,000 | 0 | 0 | 300,000 | 0 |
| Sunderland Central - Community Fire Safety Facilities | 520,000 | 0 | 0 | 520,000 | 0 |
| Appliance bay doors/lighting programme for all Stations | 100,000 | 0 | 0 | 0 | 100,000 |
| Other schemes (less than £100,000) | 375,000 | 0 | 50,000 | 0 | 325,000 |
| | 3,507,200 | 0 | 1,143,200 | 1,400,000 | 964,000 |
| | 5,809,356 | 1,300,370 | 2,109,986 | 1,400,000 | 999,000 |

## TYNE AND WEAR FIRE AND RESCUE AUTHORITY

## CAPITAL PROGRAMME 2009/2010 TO 2011/2012

| Project Description | Gross Cost | Estimated Payments To be leased | | |
|---|---|---|---|---|
| | | 2009/10 | 2010/11 | 2011/12 |
| | £ | £ | £ | £ |
| **VEHICLE REPLACEMENT PROGRAMME** | | | | |
| **2009/2010 PROGRAMME** | | | | |
| 3 Operational Support Units | 525,000 | 525,000 | 0 | 0 |
| 1 Aerial Ladder Platform | 500,000 | 500,000 | 0 | 0 |
| 10 Water Tenders | 1,750,000 | 1,750,000 | 0 | 0 |
| 8 Vans/Cars (small) | 60,000 | 60,000 | 0 | 0 |
| 2 Panel Vans (small) | 36,000 | 36,000 | 0 | 0 |
| 3 Panel Vans (large) | 66,000 | 66,000 | 0 | 0 |
| 1 Van/Car (large) | 10,000 | 10,000 | 0 | 0 |
| 1 Minibus | 20,000 | 20,000 | 0 | 0 |
| 1 Panel Van (large/chiller) | 25,000 | 25,000 | 0 | 0 |
| **2010/2011 PROGRAMME** | | | | |
| 1 Staff Car | 17,500 | 0 | 17,500 | 0 |
| 1 Minibus | 20,000 | 0 | 20,000 | 0 |
| 1 Panel Van (small) | 18,000 | 0 | 18,000 | 0 |
| 2 Panel Vans (large) | 44,000 | 0 | 44,000 | 0 |
| 16 Vans/Cars (small) | 120,000 | 0 | 120,000 | 0 |
| 10 Vans/Cars (large) | 100,000 | 0 | 100,000 | 0 |
| 7 Water Tenders | 1,225,000 | 0 | 1,225,000 | 0 |
| **2011/2012 PROGRAMME** | | | | |
| 5 Water Tenders | 875,000 | 0 | 0 | 875,000 |
| 1 Aerial Ladder Platform | 500,000 | 0 | 0 | 500,000 |
| 1 Staff Car | 17,500 | 0 | 0 | 17,500 |
| 3 Vans/Cars (small) | 22,500 | 0 | 0 | 22,500 |
| 2 Vans/Cars (large) | 20,000 | 0 | 0 | 20,000 |
| 1 Van/Car (specialist) | 12,500 | 0 | 0 | 12,500 |
| 1 Minibus | 20,000 | 0 | 0 | 20,000 |
| 3 Panel Vans (small) | 54,000 | 0 | 0 | 54,000 |
| 1 Panel Van (large) | 22,000 | 0 | 0 | 22,000 |
| | 6,080,000 | 2,992,000 | 1,544,500 | 1,543,500 |

**Appendix B**

## Prudential Indicators 2009/2010

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

P1 The actual capital expenditure that was incurred in 2007/2008 and the estimates of capital expenditure to be incurred for the current and future years that are recommended for approval are:

| | **Capital Expenditure** | | | | |
|---|---|---|---|---|---|
| | **2007/2008 £000 Actual** | **2008/2009 £000 Estimate** | **2009/2010 £000 Estimate** | **2010/2011 £000 Estimate** | **2011/2012 £000 Estimate** |
| Fire and Rescue Service | 1,704 | 2,035 | 2,110 | 1,400 | 999 |
| Emergency Planning Unit | 0 | 0 | 0 | 0 | 0 |
| **Total Spend** | **1,704** | **2,035** | **2,110** | **1,400** | **999** |

The provision for capital expenditure from 2009/2010 onwards is based on the Capital Programme 2009/2010, reported to Authority on 23rd February 2009.

P2 Estimates of the ratio of financing costs to net revenue stream for the current and future years, and the actual figures for 2007/2008 are:

| **Ratio of financing costs to net revenue stream** | | | | |
|---|---|---|---|---|
| **2007/2008 Actual** | **2008/2009 Estimate** | **2009/2010 Estimate** | **2010/2011 Estimate** | **2011/2012 Estimate** |
| (0.14)% | 0.78% | 2.25% | 2.37% | 2.37% |

The estimates of financing costs include current commitments and the proposals in this capital report. The forecast shows an increase in anticipated ratios for 2009/2010 onwards as a result of the current economic downturn, leading to lower interest rates on investments. It should be noted that ratios will vary depending on the interest rate obtained on investments and the level of investments.

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 2009/2010 elsewhere on today's agenda).

P3 Estimates of the end of year capital financing requirement for the Authority for the current and future years and the actual capital financing requirement as at 31 March 2008 are:

| Capital financing requirement | | | | |
|---|---|---|---|---|
| **31/03/08 £000 Actual** | **31/03/09 £000 Estimate** | **31/03/10 £000 Estimate** | **31/03/11 £000 Estimate** | **31/03/12 £000 Estimate** |
| 19,176 | 20,425 | 21,719 | 22,250 | 22,360 |

The Capital Financing Requirement measures the Authority's underlying need to borrow for a capital purpose. In accordance with best professional practice, Sunderland City Council, on the Authority's behalf, does not associate borrowing with particular items or types of expenditure. The Authority has an integrated Treasury Management Strategy, which has been prepared in accordance with the CIPFA Code of Practice for Treasury Management. There are, at any point in time, a number of cash flows, both positive and negative, and the treasury position in terms of its borrowings and investments is managed in accordance with the 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 taking account of the Authority's needs, 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.

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 2007/2008, nor is any difficulty envisaged for the current or future years. This view takes into account current commitments, existing plans, and the proposals in this report.

P5 In respect of its external debt, it is recommended that the Authority 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 considered necessary. These limits separately identify borrowing from other long term liabilities such as finance leases. The Authority is asked to approve these limits and to delegate authority to the Finance Officer, 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

money for the Authority. Any such changes made will be reported to the Authority at its next meeting following the change. The figures below have been calculated by reference to the overall Authorised Limit for Sunderland City Council which covers all separate bodies, including the City Council and the Fire and Rescue Authority, which are subject to the Prudential Code.

| | Authorised Limit for External Debt | | | |
|---|---|---|---|---|
| | **2008/2009 £000** | **2009/2010 £000** | **2010/2011 £000** | **2011/2012 £000** |
| Borrowing | 26,118 | 27,467 | 28,056 | 28,193 |
| Finance Lease | 74 | 68 | 62 | 56 |
| Other long term liabilities | 0 | 1,000 | 2,000 | 3,000 |
| Total | 26,192 | 28,535 | 30,118 | 31,249 |

The Finance Officer reports that these authorised limits are consistent with the Authority's current commitments, existing plans and the proposals in this report on the Capital Programme for capital expenditure and financing, and with its approved treasury management policy statement and practices. The Finance Officer 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.

In taking its decisions on the Revenue Budget and Capital Programme for 2009/2010, the Authority is asked to note that the authorised limit determined for 2009/2010, will be the statutory limit determined under section 3(1) of the Local Government Act 2003.

P6 The Authority 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, 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 Authority is also asked to delegate authority to the Finance Officer, 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. Any such changes will be reported to the Authority at its next meeting following the change.

| | Operational boundary for external debt | | | |
|---|---|---|---|---|
| | **2008/2009 £000** | **2009/2010 £000** | **2010/2011 £000** | **2011/2012 £000** |
| Borrowing | 21,118 | 22,467 | 23,056 | 23,193 |
| Finance Lease | 74 | 68 | 62 | 56 |
| Other long term liabilities | 0 | 1,000 | 2,000 | 3,000 |
| Total | 21,192 | 23,535 | 25,118 | 26,249 |

P7 The Authority's actual external debt at 31 March 2008 was £19.163 million (calculated on the basis that all Authority debt is classed as external), comprising £19.089 million borrowing and £0.074 million in respect of a finance lease. The Authority does not plan to take out any long term liabilities but has included an element for this in its calculation of the operational and authorised boundaries to allow flexibility over future financing. It should be noted that actual external debt is not directly comparable to the authorised limit and operational boundary, since the actual external debt reflects the position at one point in time and allowances need to be made for cash flow variations.

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

| For the Band D Council Tax | | |
|---|---|---|
| **2009/2010** | **2010/2011** | **2011/2012** |
| £0.05 | £0.25 | £0.39 |

The estimates show the revenue effect of all capital expenditure arising from all schemes commencing in 2009/2010 and the following two financial years. The impact on the Band D Council Tax detailed above takes account of estimated government grant funding through the Revenue Support Grant and the Authority's share of the nationally pooled Non – Domestic Rates.

These forward estimates are not fixed and do not commit the Authority. They are based on the Authority's existing commitments, current plans and the capital plans detailed in Appendix A. The cumulative effect of full-year debt charges will have an additional impact of £0.53 in 2012/2013. There are no known significant variations beyond this timeframe that would result from past events and decisions or the proposals in the budget report.

P9 Sunderland City Council, on the Authority's behalf, has adopted the CIPFA Code of Practice for Treasury Management in the Public Services.

P10 It is recommended that the Council sets an upper limit on its fixed interest rate exposures of £70 million in 2009/2010, £100 million in 2010/2011 and £100 million in 2011/2012.

P11 It is further recommended that the Council sets an upper limit on its variable interest rate exposures of £30 million in 2009/2010, £30 million in 2010/2011 and £30 million in 2011/2012.

P12 It is recommended that the Authority sets upper and lower limits for the maturity structure of its borrowings, consistent with Sunderland City Council's policy, as follows:

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

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

P13 It is proposed that the Fire and Rescue Authority funds may be invested for over 364 days within the limits set by the Sunderland City Council as set out in the Treasury Management Strategy.

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

(a) capital expenditure plans are affordable

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

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

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

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

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

(e) local strategic planning

(f) local asset management planning

(g) proper option appraisal.

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

**Appendix C**

## Treasury Management Policy Statement

1. It is a requirement of the CIPFA Code of Practice for Treasury Management in the Public Services for the Authority to produce a Treasury Management Policy Statement (TMPS).

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

   Treasury Management activities are defined as:

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

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

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

3. No change is proposed to the Authority's TMPS.

**Appendix D**

## Treasury Management Strategy Statement

### 1. Introduction

1.1 As part of the consideration of the Capital Programme, there is a need to annually consider the Treasury Management Strategy Statement in accordance with the requirements of the CIPFA Code of Practice on Treasury Management. The 2003 Prudential Code for Capital Finance in Local Authorities introduced new requirements for the manner in which capital spending plans are to be considered and approved, and in conjunction with this, the development of an integrated Treasury Management Strategy.

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

**Borrowing Strategy**

1.3 The suggested borrowing strategy for 2009/2010 in respect of the following aspects of the treasury management function is based upon the Finance Officer's views on interest rates, supplemented with leading market forecasts provided by the Authority's treasury advisor. The strategy covers:

- the past and current treasury position including interest rates;
- the borrowing requirement 2009/2010;
- the outlook for interest rates;
- capital borrowings and borrowing strategy 2009/2010;
- debt rescheduling.

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

**Investment Strategy**

1.4 The Investment Strategy comprises:

- investment objectives;
- security of capital: the use of credit ratings;
- investment defined as capital expenditure;
- provision for credit related losses;
- past performance and current position;
- outlook;
- proposed changes and investment strategy 2009/2010;
- end of year report.

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

**BORROWING STRATEGY**

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

### 2.1 Interest Rates 2008/2009

2.1.1 Interest rates have varied significantly during the current financial year, particularly at the shorter end of the market, as illustrated in the following table:

| Loan Type | March 2008 % | January 2009 % | Difference % |
|---|---|---|---|
| 7 Day Notice | 5.25 | 1.20 | (4.05) |
| 1 Month | 5.66 | 1.55 | (4.11) |
| PWLB - 1 Year | 4.21 | 0.91 | (3.30) |
| 5 Year | 4.21 | 2.91 | (1.30) |
| 10 Years | 4.56 | 3.94 | (0.62) |
| 25 Years | 4.64 | 4.69 | 0.05 |
| 50 Years | 4.42 | 4.65 | 0.23 |

The Bank of England Base Rate moved as follows:

| | | % | |
|---|---|---|---|
| February | 2008 | 5.25 | (previous change) |
| April | 2008 | 5.00 | |
| October | 2008 | 4.50 | |
| November | 2008 | 3.00 | |
| December | 2008 | 2.00 | |
| January | 2009 | 1.50 | |
| February | 2009 | 1.00 | (latest change) |

2.1.2 Shorter-term rates – the Base Rate began the financial year at 5.25%. Apart from a small reduction in April, the base rate remained at 5.00% until October when a series of significant reductions occurred in successive months. Whilst the small change in April can be attributed to seeking to combat a gradual slow down in the economy without risking an increase in inflationary pressures, the changes during the latter part of the financial year were prompted by the realisation that inflationary pressures had subsided and more significant reductions were necessary to help combat the unprecedented economic downturn in the economy and to help stimulate lending by the banking sector. Accordingly, the Monetary Policy Committee took the unprecedented step of reducing rates by 1.50% to 3.00% in November, and quickly followed this action by a further cut of 1.00% in December 2008, a further cut of 0.50% in January 2009, and a further cut in February, 2009, to leave the Base Rate at 1.00%.

2.1.3 Longer-term interest rates – Public Works Loan Board (PWLB) rates steadily increased to peak in June 2008, with the 1 to 10 year periods being approximately 1.00% to 1.50% higher than at the beginning of the financial year. Rates then steadily reduced during the year, with the greatest reductions being at the shorter end of the range

(particularly 1 to 10 years). The longer PWLB rates (25 and 50 year) remained relatively constant during the year ending marginally higher.

## 2.2 Long-term Borrowing 2008/2009

2.2.1 As part of the Treasury Management Policy and Strategy Statement which was included in the February 2008 Capital Programme report, a benchmark rate of 4.50% was set for all long-term borrowing to be undertaken in 2008/2009.

2.2.2 Borrowing required of £5.600 million for 2008/2009 was the result of the 11.75% redeemable stock maturing in November 2008. As PWLB rates are forecast to fall during 2009/2010, a decision was taken not to replace this borrowing at the present time, (see paragraph 4.2 below), as cheaper replacement borrowing is forecast to be available especially in the later periods of 2009/2010.

2.2.3 The Council had a further possible borrowing requirement of £19.500 million due to three 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 they will continue for the next rollover period.

| Start Date | Lender | Amount £m | Period (Years) | Rate % | Rollover Date | Rollover Period |
|---|---|---|---|---|---|---|
| 21/10/03 | Barclays | 5.000 | 40 | 4.50 | 23/10/08 | Every 6 Months |
| 12/06/06 | Barclays | 9.500 | 60 | 4.37 | 10/12/08 | Every 3 Years |
| 27/01/06 | Dexia | 5.000 | 60 | 4.45 | 27/01/09 | Every 3 Years |

2.2.4 The Treasury Management Strategy for 2008/2009 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".

Advantage was taken of recent favourable market conditions in January 2009 which enabled a debt rescheduling exercise to be started by the Authority. As a result £30.000 million of PWLB loans, with rates ranging from 4.15% to 4.30% (as shown in the table below), have been prematurely repaid. This was considered opportune as investment rates were averaging 1.80% (and are projected to fall even further over the coming year) and the average rate payable on the PWLB loans was on average 4.20%. It was therefore considered appropriate to repay certain PWLB loans using investments to temporarily finance this transaction as the net premium involved was very advantageous, being almost cost neutral. The debt was replaced temporarily with a loan of

£20m at a rate of 1.05%, to assist with temporary cash flow needs. The aim is then to replace the loans in 2009/2010 either:

- when the longer term PWLB is forecast to dip below 4.0%, (see paragraph 4.2 Survey of Economic Forecasts below); or if this does not happen,
- replacing the debt on a lower term or with variable rate debt at lower interest rates prior to locking in at low long term rates at some point in the future depending upon the market outlook.

| Date | Lender | Loan No | Amount £m | Period (Years) | Rate % | Premium / (Discount) £ |
|---|---|---|---|---|---|---|
| 23/01/09 | PWLB | 491437 | 6.0 | 40.5 | 4.20 | (44,804) |
| 23/01/09 | PWLB | 491438 | 5.0 | 41.5 | 4.20 | (28,346) |
| 23/01/09 | PWLB | 490874 | 4.0 | 47.0 | 4.15 | (16,049) |
| 23/01/09 | PWLB | 490875 | 4.0 | 48.0 | 4.15 | (8,101) |
| 23/01/09 | PWLB | 491673 | 4.0 | 45.5 | 4.20 | 15,823 |
| 23/01/09 | PWLB | 492604 | 2.0 | 46.5 | 4.20 | 7,953 |
| 23/01/09 | PWLB | 491874 | 4.0 | 45.5 | 4.25 | 55,671 |
| 23/01/09 | PWLB | 491694 | 1.0 | 47.0 | 4.30 | 26,179 |
| **Total Repaid** | | | **30.0** | | | **8,326** |

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 the Authority as part of the current treasury management reporting procedure.

2.2.5 There are nine market Lender's Option / Borrower's Option (LOBO) loans totalling £39.500 million. Of these £34.500 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 volatility levels by lengthening the 'roll-over' period from every six months to every three years.

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

| Start Date | Lender | Amount £m | Period (Years) | Rate % | Fixed Period | Roll Over Period |
|---|---|---|---|---|---|---|
| 21/10/03 | Barclays | 5.0 | 40 | 4.50 | 23/04/07 | Every 6 Months |

The last 'roll-over' date (23rd October 2008), unsurprisingly, 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 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 treasury portfolio position for Sunderland City Council and the Fire and Rescue Authority at 23rd January 2009 is:

| | | Principal (£m) | Total (£m) | Average Rate (%) |
|---|---|---|---|---|
| **Borrowing** | | | | |
| Fixed Rate Funding | PWLB | 98.5 | | |
| | Market | 34.5 | | |
| | Other | 0.5 | 133.5 | 4.16 |
| Variable Rate Funding | PWLB | 0.0 | | |
| | Market | 5.0 | | |
| | Temporary/ Other | 47.4 | 52.4 | 2.75 |
| **Total Borrowing** | | | **185.9** | **3.76** |
| **Total Investments** | In House | | **199.6** | **5.23** |

**3. Borrowing Requirement 2008/2009**

**Future Borrowing Requirement**

3.1 The future borrowing requirement for Sunderland City Council and the Fire and Rescue Authority at 23rd January 2009 is:

| | | 2008/09 £m | 2009/10 £m | 2010/11 £m |
|---|---|---|---|---|
| **1.** | Unsupported Capital Borrowing (potential) | 10.0 | 10.0 | 10.0 |
| **2.** | Replacement borrowing (PWLB) | 35.0 | 0. 0 | 0.0 |
| **3.** | Replacement borrowing (Market) | 0.0 | 0.0 | 0.0 |
| **4.** | Market LOBO replacement (potential) | 20.0 | 5.0 | 24.5 |
| **TOTAL – KNOWN (2+3)** | | 35.0 | 0.0 | 0.0 |
| **TOTAL – POTENTIAL (1+4)** | | 30.0 | 15.0 | 34.5 |

## 4. The Outlook for Interest Rates

**4.1** Sector Treasury Services are the appointed treasury advisers and part of their service is to assist in formulating 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 2008 summary of forecasts of 23 City and 12 academic analysts for Q4 2008 and Q4 2009 and the average 2010 to 2012 are based on 21 forecasts provided:

| Bank Rate Forecasts | | Quarter ended | | Annual Average Bank Rate | | |
|---|---|---|---|---|---|---|
| | Actual<br>% | Q4 2008<br>% | Q4 2009<br>% | Average 2010<br>% | Average 2011<br>% | Average 2012<br>% |
| **Median** | 2.00 | 2.00 | 1.00 | 3.11 | 3.97 | 4.49 |
| **Highest** | 2.00 | 4.50 | 4.00 | 4.70 | 5.00 | 5.25 |
| **Lowest** | 2.00 | 2.00 | 0.50 | 1.00 | 2.25 | 3.00 |

4.2.2 **Sector's** interest rate forecasts provided on 5th January 2009 are set out in the table below:

| | 2008/09 | 2009/10 | | | | 2010/11 | | | | 2011/12 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Q1 2009 % | Q2 2009 % | Q3 2009 % | Q4 2009 % | Q1 2010 % | Q2 2010 % | Q3 2010 % | Q4 2010 % | Q1 2011 % | Q2 2011 % | Q3 2011 % | Q4 2011 % | Q1 2012 % |
| **Bank Rate** | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.75 | 1.00 | 1.25 | 1.75 | 2.50 | 3.25 | 3.75 | 4.00 |
| **PWLB 5yr** | 2.50 | 2.25 | 2.15 | 2.15 | 2.15 | 2.45 | 2.80 | 3.15 | 3.65 | 3.95 | 4.20 | 4.45 | 4.60 |
| **PWLB 10 yr** | 3.10 | 2.75 | 2.55 | 2.55 | 2.55 | 2.85 | 3.25 | 3.65 | 4.15 | 4.40 | 4.70 | 4.75 | 4.85 |
| **PWLB 25y** | 4.00 | 3.95 | 3.95 | 3.95 | 4.00 | 4.15 | 4.35 | 4.45 | 4.60 | 4.85 | 4.95 | 5.00 | 5.05 |
| **PWLB 50yr** | 3.85 | 3.80 | 3.80 | 3.80 | 3.85 | 3.90 | 4.00 | 4.25 | 4.40 | 4.70 | 4.80 | 4.95 | 5.00 |

4.2.3 **Capital Economics** interest rate forecast -19th January 2009

| | 2008/09 | 2009/10 | | | | 2010/11 | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 2009 % | Q2 2009 % | Q3 2009 % | Q4 2009 % | Q1 2010 % | Q2 2010 % | Q3 2010 % | Q4 2010 % |
| **Bank Rate** | 0.50 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| **PWLB 5yr** | 1.65 | 1.45 | 1.45 | 1.45 | 1.45 | 1.45 | 1.45 | 1.45 |
| **PWLB 10 yr** | 2.65 | 2.15 | 2.15 | 2.15 | 2.15 | 2.15 | 2.15 | 2.15 |
| **PWLB 25y** | 4.15 | 4.00 | 3.80 | 3.65 | 3.65 | 3.65 | 3.65 | 3.65 |
| **PWLB 50yr** | 4.05 | 3.95 | 3.85 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 |

## 4.3 Economic Background

4.3.1 Introduction

- The sub prime crisis of early 2008 was superceded by the banking crisis of autumn 2008. The world banking system came near to collapse and governments around the world were forced to recapitalise and rescue their major banks. The resulting shortage of lending from banks anxious to preserve capital led to economic forecasts being sharply reduced and the effect of a recession was priced into the markets. This in turn led to sharp falls in oil and other commodity prices with the result that inflation, which in the UK was running at over 5%, dramatically reduced and recession fears drove interest rate sentiment and policy. A co-ordinated global interest rate cut of 50bp took place on 8th October 2008 and further cuts were effected in the UK as the country was heading for recession.

4.3.2 International

- Early in 2008 the US economy was being badly affected by the housing market slump. Interest rates were at 2% and inflation was being dragged higher by the uncontrollable rise in commodity prices. The ECB was very concerned about rising inflation and less about the state of the economy at that time.
- The second quarter of 2008/2009 was torn between inflation worries on the one hand, with oil rising towards $150 per barrel, and the deteriorating economic outlook on the other.
- In the second and third quarters of the financial year the financial crisis erupted and escalated as the world became aware of the extent of the sub-prime position and the impact it was having on institutions that had invested in them.
- In September Fannie Mae/Freddie Mac (the mortgage banks) and AIG, the insurance giant, had to be bailed out by the US Federal Government.

- Then in mid September, Lehman Bros., the investment bank, was allowed to fail. This triggered a domino effect with other banks and financial institutions having to be rescued or supported by governments around the world.
- After the collapse into receivership of the Icelandic banks in early October, other countries then started to feel the strain and a number had to approach the IMF for support.
- Eventually the Asian economies were affected, including India and China, and it became clear that the crisis had become fully global one and no country was insulated from it.
- The financial crisis had developed into an economic crisis and there was a co-ordinated global interest rate cut with the Fed, ECB and MPC all cutting rates by 50bp on 8th October, 2008. The Fed subsequently cut rates again by 50bp to 1% on 29th October and again on 16th December to a band of 0.00% to 0.25% in an attempt to stave off the oncoming recession.
- The ECB reduced rates again on 6th November by 50bp and also by its biggest ever cut of 75bp on 4 December to reach 2.5%. Rates were also reduced by a further 50bp on 14th January 2009 and the rate is now currently 2.00%.

4.3.3 United Kingdom (UK)

- GDP: growth was already slowing in 2008 from 2007 before the full impact of the credit crunch was felt. Earlier in 2008 GDP was 2.3% whereas in the autumn the figure fell back to -0.3% and was then expected to continue this negative trend into 2009.
- Wage inflation remained relatively subdued as the Government kept a firm control on public sector pay. Private sector wage growth was kept in check by the slowing economy.
- Growth slowed across the economy and unemployment rose throughout the year with forecasts of 2 million unemployed by the end of the financial year and continuing to increase thereafter through 2010.
- Notwithstanding the pressures on household finances consumer spending still continued at a reasonable pace although the trend was slowing as the year progressed.
- Bank lending came to a virtual standstill in the autumn as the credit crunch tightened its grip and a number of banks had to be rescued, or supported, by the government.
- The Government and Bank of England supplied massive amounts of liquidity to the banking market in an attempt to re-ignite interbank lending.
- The Government took action in September to either supply finance itself to recapitalise some of the major clearing banks or to require the others to strengthen their capital ratios by their own capital raising efforts. This was so that these banks would be seen to have sufficient reserves to last through the coming recession with its inevitable increase in bad loans etc.
- The housing market also came to a virtual standstill as lenders demanded larger deposits and higher fees. House sales and prices both dropped sharply.

- Government finances deteriorated as income from taxation dropped as the economy slowed and the cost of the bailout of the banks was added to the deficit.
- U.K. equity prices declined sharply in the 3rd and 4th quarters as the impending recession was priced into the markets. Prices hit five year lows and volatility was extremely high.
- After the initial concerns about the impact of the credit crunch in the earlier part of 2008 it appeared as though the storm had been weathered. The MPC had been very concerned about CPI inflation, which had been rising sharply on the back of higher commodity and food prices. The Bank Rate reached a peak of 5.75% in July 2007 after which cuts of 0.25% occurred in December 2007 and February and April 2008 before the major cuts made in the autumn. The economic data had been indicating a slowing economy for some while but it was not sufficiently weak to force the MPC into another cut, however it was the strength of the banking crisis, pre-empted by the collapse of Lehmans in New York that eventually drove the MPC to cut interest rates by 50bp on 8th October 2008 in conjunction with the Federal Reserve, the ECB and other central banks. It was then appreciated that the economic downturn would be much more severe than previously thought and interest rates were subsequently reduced by 150bps on 6th November and by a further 100bps on 4th December and the base rate currently stands at 1.5%.
- The LIBOR spread over Bank Rate has also been a feature, and a concern, of 2008/2009. Because of credit fears and the reluctance of lenders to place cash for long periods, 3 month LIBOR (this is the London Inter Bank Offer Rate – the rate at which banks will lend to one another), has been substantially higher than the Base Rate. This has meant that the MPC's power over monetary policy has been eroded by the widening of this spread between LIBOR and Base Rate and it has therefore had a limited ability to bring relief to hard pressed borrowers through lower interest rates. However, the power of the Government over the semi nationalised clearing banks had considerable impact in enforcing pro rata reductions to the 150 bps Base Rate cut in November on some borrowing rates.
- The pre Budget Report on 14th November revealed the Government's plans for a significant increase in Government borrowing over coming years as a result of falling tax revenues and also due to tax cuts and increases in Government expenditure in the short term designed to help stimulate economic growth to counter the recession.

### 4.4 Base Rate Forecast

Sector has advised that they expect the Bank Base Rate to be cut by a further 1.00% in the first quarter of 2009 which will mean that the Base Rate will be 0.50%, where it is expected to remain for the rest of 2009/2010. From April 2010 the Base Rate is expected to steadily rise again until it reaches 4.00% by March 2012. However, there is a

downside risk to this forecast if the recession proves to be deeper and more prolonged than is currently anticipated.

### 4.5 Long-term PWLB Rates

With regard to the PWLB interest rates, the shorter periods are more influenced by the Base Rate whereas the longer periods are more sensitive to inflation, both actual and expected. Sector is forecasting the PWLB rates to be at their lowest in Q4 2009 (5 year being 2.15% and 50 year being 3.80% to 3.90%), and are then projected to slowly increase over the following two years.

## 5. Capital Borrowings and Borrowing Strategy for 2009/2010

**5.1** Variable rate borrowing is expected to become cheaper with the Base Rate being forecast to fall to 0.50% in Q1 2009. Thereafter variable rate borrowing is expected to remain at this level until Q2 2010 before rising to 4.0% over the following two years.

The forecast for the long-term PWLB rates is to fall in Q2 2009 (i.e. 25 year – 3.95% and 50 year – 3.80% to 3.90%) and remain around these levels until Q1 2010 before slowly increasing to 5.05% for 25 year and 5.00% for 50 year by the end of 2011/2012.

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

### 5.2 Sensitivities of the Forecast

The main sensitivities of the forecast are likely to be the two scenarios below. The Finance Officer, 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 Finance Officer in conjunction with treasury adviser's guidance considers a benchmark financing rate of 4.00% for any further long-

term borrowing for 2009/2010 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.

It is possible that if long term rates do not fall then some investment balances may be considered to fund the borrowing requirement in 2009/2010. In addition, the Authority may not need to borrow further depending upon the completion of various capital schemes. However the need to adapt to changing circumstances will be required, and flexibility will be retained to adapt to such changes.

The Finance Officer, in conjunction with 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 to take place will include:

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

In previous years debt rescheduling has achieved significant savings in interest charges and discounts and these interest savings have been secured for many years to come. However, changes to the PWLB rules in 2007, in respect of replacement loans largely removed the potential for debt rescheduling unless dramatic changes in interest rates are forecast or occur. Such has been the case in the latter part of 2008 and is forecast for the next period.

The latest interest rate projections for 2009/2010 would indicate that it seems likely that there may be some debt rescheduling opportunities in 2009/2010. The PWLB longer term rates are projected to fall to their lowest rate, (below 4%), for some time and consequently the Authority 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.

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

## Investment Strategy

## 7. Introduction

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

**7.2** This Investment Strategy is a requirement under the Government's Guidance on Local Government Investments. The Investment Strategy states which investments the Authority 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, (which are for greater than one year – up to a maximum of 5 years), clearly can present a higher risk than the previous 364 day investment limit.

**7.3** This Strategy sets out:

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

## 8. Investment Objectives

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

(A) The **security** of capital;
(B) The **liquidity** of its investments and then
(C) The Authority aims to achieve the **optimum return** 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** The Authority uses credit ratings published by Fitch IBCA to inform the credit quality of counterparties, and where a counterparty does not have a Fitch rating, the equivalent Moody's or Standard and Poor's rating will be used. The credit rating criteria used to identify "Approved Organisations for Investments" and their Authorised Investment Limits are consistent with those previously approved and are set out in Annex 1 for information.

**9.2 Monitoring of credit ratings:**

- All credit ratings are monitored on a daily basis. The Authority has access to both Fitch and Moody's credit ratings 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 Authority's minimum criteria, the counterparty will be withdrawn from the Authority's Approved Lending List. The Authority will also immediately inform its external fund manager(s), if used, of the withdrawal of the same.

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

- If fund managers are employed by the Authority, the Authority 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 Authority's policy.

**9.3** Since the credit crunch crisis there have been a number of developments which require separate consideration and will also inform the investment strategy.

**9.3.1 Nationalised Banks**

In the UK, nationalised banks have credit ratings which do not conform to the credit criteria usually used by local authorities to identify banks which are of high credit worthiness. In particular, as they are no longer separate institutions in their own right, it is impossible for Fitch to assign them an individual rating for their stand alone financial strength. Accordingly, Fitch have assigned an 'F' rating which means that at a historical point of time, this bank 'failed' and is now owned by the Government. However, these institutions are now recipients of an F1+

short term rating and as such they have effectively taken on the creditworthiness of the Government itself i.e. deposits made with them are effectively being made to the Government. They also have a support rating of 1; as they are being actively supported by the government. In other words, on both counts, they have the highest ratings possible, although their individual credit rating will not meet the Authority's criteria. It is proposed that the Authority adopts these institutions on the basis that they are appropriately supported by the government.

### 9.3.2 Blanket Guarantees on all Deposits

Some countries have supported their banking system by giving a blanket guarantee on all deposits e.g. Ireland. The view could be taken that the sovereign credit rating of a particular country then takes 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 Authority's Treasury Advisers have indicated that only AAA sovereign credit ratings for a particular country are considered appropriate in these circumstances. In addition, consideration will be given to the outlook and other information available at the time of making individual deposits.

### 9.3.3 UK Banking System - Support Package - 8th October, 2008

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 represents 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 banks and building societies within the UK, subject to the lending list criteria set out at Annex 1.

### 9.3.4 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. This factor has also been considered in framing the lending list.

### 9.3.5 UK Banking System - Additional Support Package

On 13th 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.

**9.3.6 The Irish Government Guarantee**

The Irish Government has guaranteed all retail and corporate deposits, interbank deposits, senior unsecured debt, covered bonds (including asset covered securities); and dated subordinated debt (Lower Tier 2) until 29th September 2010. The country presently has a sovereign credit rating of AAA.

## 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 Authority to another body for capital expenditure by that body is also deemed by regulation to be capital expenditure by the Authority. It is therefore important for the Authority 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 Authority for 'specified' and 'non-specified' investments.

**10.3** The Authority 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 Authority'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 Authority 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 2008/2009 the Authority did not employ any external fund managers, all funds being managed in-house.

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

| | 2007/08 Return % | 2007/08 Benchmark % | 2008/09 Return % Year to date | 2008/09 Benchmark % Year to date |
|---|---|---|---|---|
| Council | 5.70 | 5.57 | 5.23 | 4.22 |

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

## 13. Outlook and Proposed Investment Strategy 2009/2010

**13.1** Based on cash flow forecasts, the Authority, together with the City Council, anticipates its fund balances in 2009/2010 are likely to range between £160m and £220m which represents a cautious approach and provides for unanticipated levels of advanced funding through grants and for unexpected and unplanned levels of slippage and underspending. However in 2009/2010, if short-term interest rates fall materially below long-term rates, it is possible that some investment balances may be used to fund some long-term borrowing. Such funding is wholly dependent upon market conditions and will be assessed and reported if and when the appropriate conditions arise.

**13.2** There is no commitment to any investments, which are due to commence in 2009/2010, (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 Sunderland City Council will hold in short-term investments (less than one year) is £50m. As it has decided to restrict most of its investments to term

deposits, it will maintain liquidity by having a minimum of 50% of these short-term investments maturing within 6 months.

**13.5** A maximum of £100m is to be set for Sunderland City Council's in-house non-specified investments over 364 days up to a maximum period of 2 years. The Finance Officer will monitor long-term investment rates and identify any investment opportunities if market conditions change. This will enable the Authority 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 will follow the criteria as set out in Annex 1.

**13.7** The Finance Officer, in conjunction with treasury adviser Sector Treasury Services, and taking into account the minimum amount to be maintained in short-term investments has, and will continue to, look to lengthen the average investment periods to lock in at the better investment returns as appropriate. The strategy will continue to monitor investment rates closely and to identify any appropriate investment opportunities that may arise.

**13.8** The Authorty 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 Annex 1);
- they will be allowed to invest in term deposits, Certificates of
- Deposit (CD's) and government gilt securities;
- An investment limit of £3m per institution (per manager);
- A maximum limit of 50% fund exposure to government gilts;
- A maximum limit of 10% fund exposure to supranational investments;
- A maximum proportion of the fund invested in instruments carrying rates of interest for periods longer than 364 days shall not exceed 50%. Again, it is proposed to only recommend the use of fixed term deposits up to a maximum of 2 years.

**13.9** The details regarding the types of investment and the time periods to be permitted for investments are detailed in the Approved Lending List (Annex 1) and also with reference to the Lending List Criteria set out in (Annex 1).

**13.10** It is further proposed that:

- UK nationalised banks (or banks where the government have taken a substantial stake) will be included in the Lending List and that the criteria applied will be the Government's AAA

rating, however, as they will only have a short term F1+ rating - this in effect means that the maximum period funding can be placed with these institutions is up to a maximum of 364 days, unless a lesser period of guarantee has been stated by the government;

- The main 8 UK institutions benefiting from the Government's Credit Guarantee Scheme should have the AAA credit rating applied to them 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
- Investments be limited to UK institutions only at this stage and that the position is kept under review;
- Delegated authority be given to the Finance Officer, to vary the Lending List Criteria and Lending List itself should circumstances dictate, on the basis that changes be reported retrospectively, in accordance with normal Treasury Management reporting procedures.

## 14. End of Year Report

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

**Annex 1 a)**

# Sunderland City Council

## LENDING LIST CRITERIA

UK Institutions only

**<u>Fitch IBCA Long-term Credit Ratings</u>**

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

| | | | |
|---|---|---|---|
| AAA, or AA+ | AAA, or AA+ | AAA, or AA+ | AAA, or AA+ |
| AA | AA | AA | AA |
| AA- | AA- | AA- | AA- |
| A+ or A | A+ or A | A+ or A | A+ or A |
| A- | | | |

Where nationalisation or part nationalisation has occurred, the AAA rating for the UK will be used.

**Fitch IBCA / Moody's Short-term Ratings**

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

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

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

| | **<u>£m</u>** | **<u>Maximum Investment Period</u>** |
|---|---|---|
| Local Authorities (limit for each local authority) | 30 | 364 Days |

**Annex 1 b)**

# Sunderland City Council

## Approved Lending List

This list reflects the changes made since 8th October 2008:

| Institution | Country | Fitch IBCA Long Term | Fitch IBCA Short Term | Moody's Long Term | Moody's Short Term | Total Limit £m | Max. Deposit Period |
|---|---|---|---|---|---|---|---|
| Abbey National plc | UK | AA- | F1+ | Aa3 | P-1 | 20 | 364 Days |
| Alliance & Leicester plc | UK | AA- | F1+ | Aa3 | P-1 | 20 | 364 Days |
| Bank of Scotland (HBOS) | UK | AA- | F1+ | Aa1 | P-1 | 20 | 364 Days |
| Barclays Bank plc | UK | AA | F1+ | Aa1 | P-1 | 25 | 2 Years |
| HSBC Bank plc | UK | AA | F1+ | Aa1 | P-1 | 25 | 2 Years |
| Lloyds TSB Bank plc | UK | AA- | F1+ | Aaa | P-1 | 20 | 364 Days |
| National Westminster Bank / Royal Bank of Scotland/Ulster Bank | UK | AA- | F1+ | Aa3 | P-1 | 20 | 364 Days |
| Northern Rock plc * | UK | A- | F1+ | A2 | P-1 | 5 | 364 Days |
| * Nationalised - Government guarantee is in place on a rolling 3 month basis | | | | | | | |
| | | | | | | | |
| **Top 10 Building Societies** | | | | | | | |
| Nationwide B.S. | UK | AA- | F1+ | Aa2 | P-1 | 20 | 364 Days |
| Britannia B.S. | UK | A- | F2 | A2 | P-1 | 5 | 6 Months |
| Yorkshire B.S. | UK | A | F1 | A2 | P-1 | 10 | 364 Days |
| Coventry B.S. | UK | A | F1 | A2 | P-1 | 10 | 364 Days |
| Chelsea B.S. | UK | A- | F1 | A2 | P-1 | 5 | 364 Days |
| Leeds B.S. | UK | A | F1 | A2 | P-1 | 10 | 364 Days |
| West Bromwich B.S. | UK | A- | F2 | A2 | P-1 | 5 | 6 Months |
| Skipton B.S. | UK | A | F1 | A2 | P-1 | 10 | 364 Days |
| Principality B.S. | UK | A- | F2 | A2 | P-1 | 5 | 6 Months |
| Newcastle Building Society | UK | A- | F1 | A2 | P-1 | 5 | 364 Days |