

***Report of the Audit and
Governance Committee***

THE AUDIT AND GOVERNANCE COMMITTEE reports and recommends as follows:

1. Annual Report on the work of the Audit and Governance Committee 2009/2010

That they have given consideration to a report by the Director of Financial Resources and Chief Solicitor (copy attached) on the work of the Audit and Governance Committee during 2009/2010, this being their first Annual Report to Council.

Accordingly, the Committee recommends Council to note the Annual Report on the Work of the Audit and Governance Committee 2009/2010.

2. Treasury Management Review of Performance 2009/2010

That they have given consideration to a report by the Director of Financial Resources (copy attached) on 29 June 2010 on the annual borrowing and investment performance for the financial year 2009/2010, produced in accordance with the requirements of the Treasury Management Policy and Strategy, agreed by Council, and reported to Council to comply with the requirements of the new CIPFA Treasury Management Code of Practice.

The report was also noted by at the Cabinet meeting held on 21 July 2010.

Accordingly, the Committee recommends Council to note the Treasury Management Review of Performance 2009/2010.

AUDIT AND GOVERNANCE COMMITTEE

29th June 2010

**ANNUAL REPORT ON THE WORK OF THE AUDIT AND GOVERNANCE
COMMITTEE - 2009/2010**

Report of the Director of Financial Resources and Chief Solicitor

1. Purpose of Report

- 1.1 This report provides a summary of the work undertaken by the Audit and Governance Committee during 2009/2010 and the outcome of this work. The purpose of this report is to demonstrate how the Committee has fulfilled its role. This is the first annual report on the work of the Committee and the report will also be presented to Council.

2. Background

- 2.1 The Audit Commission's review of the Effectiveness of Internal Audit in May 2009 identified that the Audit and Governance Committee had not reviewed its remit and effectiveness since its inception in April 2006. It was agreed at the Committee meeting on 22nd May 2009 that a workshop would be held to carry out the review, which took place on 20th July 2009. One of the agreed actions which resulted from the review was that an annual report would be prepared on the work of the Committee.

3. Role of the Committee

- 3.1 The Audit and Governance Committee is a key component in the Council's Corporate Governance Arrangements. Its role is to:
- to approve the Authority's Statement of Accounts, income and expenditure, and balance sheet or record of receipts and payments (as the case may be).
 - consider the effectiveness of the authority's corporate governance arrangements, risk management arrangements, the control environment and associated anti-fraud and anticorruption arrangements and seek assurance that action is being taken on risk-related issues identified by auditors and inspectors;

- be satisfied that the authority's assurance statements, including the Annual Governance Statement, properly reflect the risk environment and any actions required to improve it.

3.2 To enable the Committee to fulfil its role effectively awareness / update sessions have been held to provide members of the Committee with information on relevant issues. Sessions provided include the following:

- The Sunderland Strategy and the Council's Corporate Improvement Plan.
- Statement of Accounts.
- Treasury Management.
- Comprehensive Area Assessment and Use of Resources.

4. Review of the Remit and Effectiveness of the Committee

4.1 During the year the Committee undertook a review of its remit and effectiveness. This was undertaken through a workshop which considered an assessment of the Terms of Reference for the Committee against guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA), '*Audit Committees: Practical Guidance for Local Authorities*'. A self assessment, based on the CIPFA guidance, was completed during the workshop following detailed discussion by committee members in relation to each area of the operation of the Committee. The self assessment was supported by a list of all of the previous reports which had been presented to the Committee, detailing the purpose of each report and its impact. The External Auditor was also present at the workshop and provided advice and commentary as appropriate.

4.2 The results of the review concluded that, in the main, the current arrangements compare favourably to the CIPFA guidance. However, a number of recommendations were agreed where it was considered that the current arrangements could be improved or enhanced. All but one of the recommendations have been implemented, the remaining recommendation is not yet due for implementation.

5. Matters Considered

5.1 The Committee has met six times during the course of the year to consider a range of issues. Appropriate officers of the Council have been in attendance at the meetings to present reports and provide additional information in order to clarify issues and respond to questions from members of the Committee. Regular attendees at the meetings are the Council's Monitoring Officer (Chief Solicitor), the Director of Financial Resources, the Head of Audit, Risk and Procurement and the Council's External Auditors.

5.2 To enable the Committee to fulfil its role as set out in paragraph 3.1, a range of reports are considered to enable the appropriate decisions to be taken. Appendix 1 shows the list of reports which were considered at each meeting. A summary of the issues considered is as follows:

- a) The committee endorsed the Internal Audit Strategy and Operational Plan, which sets out the arrangements for providing internal audit services within the Council and to associated bodies, the plan of audit work for the year and the performance indicators that Internal Audit Services will be measured against. The Committee was also given the opportunity to identify any areas of concern to be considered for the Internal Audit Plan for 2010/2011.
- b) An interim progress and Annual Report from Internal Audit were presented to provide details of Internal Audit's performance in relation to the agreed performance indicators and to provide members of the Committee with an opinion on the overall internal control environment within the Council. Specific key issues are also highlighted within the reports for members to consider further, for example, ICT disaster recovery.
- c) An annual review of the effectiveness of Internal Audit is carried out and the results of this review were reported to members to provide assurance that the arrangements in place are sound.
- d) External Auditors provided reports detailing their Annual Audit and Inspection Plan, their fees, the Annual Audit Letter, and results of the Comprehensive Area Assessment and Use of Resources judgement. Further reports on specific pieces of work carried out within the Council were also presented to provide members with a view of the arrangements in place, for example, the Council's Asset Management arrangements.
- e) Reports were presented in relation to the Corporate Risk Profile and the risk management arrangements within the Council, to provide assurance to members that key risks are being effectively managed.
- f) The results of the Annual Governance Review were presented, which summarises the overall governance arrangements in place within the Council. This review sets out all of the sources of evidence (including the reports mentioned above) that are used to prepare the draft statement in relation to the Council's overall control environment. This statement, the Annual Governance Statement, was approved by the Committee and included within the Council's Statement of Accounts.
- g) The annual Statement of Accounts (subject to audit) was presented for members to challenge and approve before they were made available for public inspection and to the external auditors. Once the external auditor had completed the audit, any amendments were submitted back to the Committee

for approval. In addition, the Committee received information regarding the implications of the International Financial Reporting Standards, which the Council will have to comply with in the coming years.

- h) The Committee received reports in relation to the Council's Treasury Management arrangements to receive assurance that they are appropriate and in line with recently issued good practice.
- i) During the year, the Chairman of the Audit and Governance Committee attended the North East Public Service Audit Committee Chairs' Forum, which considers and compares the activity of the various audit committees across the public sector in the North East. The Chairman had reported that there were clear differences in how Authorities approached the operation of their Audit Committees. It was noted that the Audit and Governance Committee had identified areas for development during the Review of the Remit and Effectiveness of the committee. It was agreed that the Committee would benefit from receiving the results of the Comprehensive Area Assessment and any other cross Council audit or inspection reports in future.

5.3 From the reports presented the Committee has been proactively monitoring performance in a number of areas and requesting improvement. These are as follows:

- *ICT Disaster Recovery arrangements* - In the Internal Audit Annual Report for 2008/2009, the position regarding business continuity / contingency planning for ICT was reported as being satisfactory in three of four areas, with the unsatisfactory opinion being in relation to the recovery of key applications. Since this time the Committee has requested regular updates regarding progress in addressing the situation relating to the recovery of key applications. The arrangements improved significantly during 2009/2010 resulting in a satisfactory opinion being issued in the Internal Audit Annual Report for the year. The Committee is continuing to receive information regarding improvements in this area.
- *Strategic Asset Management* – The Audit Commission presented a report in relation to the arrangements for Strategic Asset Management within the Council in May 2009. The report concluded that although good progress had been made to develop the arrangements there was more to be done in some areas, specifically in relation to developing a strategic approach to managing and acquiring assets within the city. The Committee requested a further report detailing progress in implementing the recommendations. A report regarding progress was provided in March 2010, with further progress reports requested.

- *Implementation of Agreed Internal Audit Recommendations* – In the Internal Audit Annual Report for 2008/2009 it was reported that the rate of implementation of agreed medium risk recommendations stood at 84% against a target of 90%. A breakdown of performance by directorate was provided. The Committee noted that there was low performance in some areas of the Council and asked for this to be monitored through the Committee. Whilst the Internal Audit Annual Report for 2009/2010 has reported that the overall implementation rate has remained the same (at 84%) the performance during the latter part of the year shows an improvement. Performance in this area will continue to be monitored by the Committee.

5.4 It can be seen that the work of the committee is wide ranging with members monitoring performance more closely in those areas where it is deemed improvements are required.

6. Recommendations

6.1 The Committee is asked to consider the report and provide any comments for inclusion prior to the report being presented to Council.

Background Papers

Reports submitted to the Audit and Governance Committee during 2009/2010

Reports presented to the Audit and Governance Committee 2009/2010

Date	Report of	Title	Purpose	Impact
22 May 2009	City Treasurer and City Solicitor	Annual Review of Effectiveness of Internal Audit 2008/2009	Receive assurance	Members asked specific questions regarding areas of the self assessment leading to improvements in areas discussed.
	City Treasurer	Treasury management in Local Authorities	Receive assurance. Agree to receive reports and monitor compliance with the Treasury Management policy in the future	Additional member review of treasury management practices.
	Audit Commission	Review of Asset Management	Receive information on a specific area of the council	Discussion of the Audit Commission report and a request for further progress reports regarding the implementation of the recommendations.
30 June 2009	Director of Financial Resources	Internal Audit Services Annual Report 2008/2009	Provide an opinion on the performance of internal audit, and the overall internal control environment raising any significant issues	Request for action to improve recommendation implementation rates, including further reports on this issue.
	Director of Financial Resources	Risk Management Annual Report 2008/2009	Provide an opinion on the adequacy of the risk management arrangements in place	Assurance provided.
	Director of Financial Resources and Chief Solicitor	Annual Governance Review	Approval of the Statement Reporting reviews on Internal Control and Internal Financial Control	Specific questions raised on the action plan focusing officer's attention.
	Audit Commission	Audit Fees 2009/2010	For information	
	Director of Financial Resources	Statement of Accounts 2008/2009 (subject to Audit)	Approve the statement of accounts subject to audit	Specific questions raised by members on the accounts. Explanations received.
29 September 2009	Chief Executive and Director of Financial Resources	Summary of the Sunderland Strategy and the Council's Corporate Improvement Plan	For information	

Date	Report of	Title	Purpose	Impact
	Director of Financial Resources	International Financial Reporting Standards	For information	
	Director of Financial Resources	Audited Statement of Accounts	Approval of the amended statement of accounts	Statement of Accounts approved.
	Director of Financial Resources	Assessment of the Remit and Effectiveness of the Audit and Governance Committee	Provide a summary of the assessment and approve the recommended improvements	Assessment was agreed and improvements to the working of the Committee were agreed.
27 November 2009	Director of Financial Resources	New Corporate Risk Profile	Receive assurance	Members asked specific questions regarding the entries in the profile and requested that the Head of Strategic Economic Development be invited to a future meeting to outline the Economic Master Plan.
	Director of Financial Resources	Internal Audit Plan Consultation 2010/2011	Provide Members of the Committee the opportunity to contribute to the development of the Internal Audit Plan for 2010/2011	Members discussed areas for consideration in formulating the Internal Audit Plan.
	Director of Financial Resources	Internal Audit Progress Report 2009/2010	Receive assurance	Specific queries were raised regarding the work undertaken.
	Director of Financial Resources	Treasury Management – Review of 2008/2009 and mid year review 2009/2010	Receive assurance	
15 February 2010	Director of Financial Resources	Capital Programme – Third Review 2009/2010, Provisional Resources and Treasury Management Review	Receive assurance and provide comments as required	Assurance received, arrangements were commended.
	Director of Financial Resources	Capital Programme 2010/2011, including Prudential Indicators and Treasury Management Strategy and Policy	Receive assurance and provide comments as required	Various questions were asked by members and explanations received.

Date	Report of	Title	Purpose	Impact
	The Chairman	North East Public Service Audit Committee Chair's Forum	Discuss the issues raised at the Forum and consider any areas for further development	It was agreed that the Committee would benefit from receiving the results of the Comprehensive Area Assessment and any other cross Council audit or inspection reports in future.
26 March 2010	Director of Financial Resources	Internal Audit Strategy and Operational Plan 2010/2011	Endorsement of the updated Internal Audit Strategy and Operational Plan	Specific questions regarding areas included within the Operational Plan were raised. The Operational Plan was endorsed.
	Director of Financial Resources	Corporate Risk Profile – Update	Receive assurance	Comments were made regarding the report. It was agreed that in future it would be more appropriate for members to receive a summary of the key areas of activity and updates presented.
	Deputy Chief Executive	Review of Strategic Asset Management	Review progress in implementing recommendations made by the Audit Commission	Progress was noted and further updates were requested by the Committee.
	Chief Executive	Comprehensive Area Assessment	Receive assurance in relation to the findings of the Comprehensive Area Assessment	Questions were asked in relation to specific issues highlighted in the report. Assurance was received regarding the actions being taken to improve some areas that had been 'red tagged' as part of the Assessment.
	Chief Executive and Director of Resources	Annual Audit Letter	Receive assurance from the Council's external auditors in relation to 2008/2009	Specific queries were raised on the report. The Chairman asked the District Auditor to press on with trying to resolve the objections to both the 2007/2008 and 2008/2009 accounts.
	Director of Financial Resources	Proposed Schedule of Reports 2010/2011	Approve the reports to be presented to the Committee	Reports approved. Chairman also asked for some issues from the Annual Audit Letter to be covered.
	Director of Financial Resources	International Financial Reporting Standards – Progress Report	Receive assurance regarding progress in complying with the standards	

AUDIT AND GOVERNANCE COMMITTEE

29 June 2010

TREASURY MANAGEMENT – REVIEW OF PERFORMANCE 2009/2010

Report of the Director of Financial Resources

1 Purpose of the Report

1.1 To report on the borrowing and investment performance for 2009/2010.

2 Description of Decision

2.1 The committee is requested to note the Treasury Management performance for 2009/2010.

3 Introduction

3.1 This report sets out the annual borrowing and investment performance for the financial year 2009/2010, in accordance with the requirements of the Treasury Management Policy and Strategy agreed by Council.

4 Review of Performance 2009/2010

Borrowing Strategy and Performance – 2009/2010

- 4.1 Cabinet agreed the Borrowing Strategy on 11th February 2009 and this was approved by Council on 4th March 2009. The basis of the strategy was to:
- continuously monitor prevailing interest rates and forecasts;
 - secure long-term funds when market conditions were favourable;
 - use a benchmark financing rate of 4.00% for long term borrowing (i.e. all borrowing for a period of one year or more);
 - take advantage of debt rescheduling opportunities, as appropriate.
- 4.2 The Borrowing Strategy was reviewed by this committee in November 2009 and February 2010 and was reaffirmed on both occasions. The Borrowing Strategy for 2009/2010 was based upon interest rate forecasts from a wide cross section of City institutions, advice from the Council's Treasury Management advisers and from other available information sources e.g. The Financial Times, Treasury and Government forecasts etc.

- 4.3 This report also incorporates the requirements of the revised Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009, which was issued in December 2009 and was formally adopted by the Council on 3rd March 2010. The Council adopted most of the changes recommended in the revised Code earlier in the financial year, in response to a CIPFA consultation paper on Treasury Management and recommendations set out in the "Risk and Return" report issued by the Audit Commission, which was brought about by the Icelandic banking crisis. The actions proposed and adopted were reported to this Committee and to Cabinet in June 2009.
- 4.4 The view in February 2009, at the time the Treasury Management Policy and Strategy was formed, was that variable rate borrowing was expected to become cheaper as the Base Rate was forecast to fall to 0.50% by the end of March 2009. Thereafter variable rate borrowing was expected to remain at this level until Qtr 1 of 2010 before slowly rising to 4.0% over the following two years. The forecast for the long-term PWLB rates was for rates to fall in Q2 2009 (i.e. 25 year loans – 3.95% and 50 year loans between 3.85% and 3.90%) and would remain around those levels until Q1 2010 before slowly increasing to 5.05% for 25 year loans and to 5.00% for 50 year loans by the end of 2011/2012.

As expected, the Base Rate did fall to 0.50% in March 2009, where it has remained to the present day. However, as can be seen from the table below (showing the average borrowing rates for each quarter in 2009/2010) the longer term rates have been higher than the levels forecast:

Borrowing Period	Projected Rates	Actual Rates 2009 / 2010			
		Q1 %	Q2 %	Q3 %	Q4 %
7 day notice	0.5	0.46	0.38	0.31	0.30
1 year	-	0.97	0.93	0.83	0.87
5 year	2.18	2.80	2.97	2.83	2.99
10 year	2.60	3.72	3.88	3.91	4.22
25 year	3.95	4.57	4.43	4.35	4.64
50 year	3.85 to 3.90	4.66	4.45	4.36	4.62

During 2009/2010 the Bank of England's Monetary Policy Committee (MPC) was focused on helping the economy to recover from the deepest and longest recession the UK economy had experienced for many years. Despite keeping the Base Rate at an unprecedented historically low of 0.5% all year, the MPC also decided to increase the amount of liquidity (i.e. the quantity of money) in the economy by £200 billion. This process, known as 'quantitative easing', injects money into the economy, primarily by buying UK government bonds (known as gilts). As well as increasing liquidity, this also has the effect of boosting prices for gilts and corporate bonds, thereby bringing down yields, with the effect of reducing borrowing costs for both the business and the public sectors, particularly in the short to medium term borrowing periods.

4.5 The Council's borrowing requirement for 2009/2010 was assessed at around £35.0 million (as a result of 11.75% redeemable stock maturing in November 2008 and £30.0 million PWLB loans being prematurely repaid in January 2009). This borrowing was deferred from 2008/2009 as interest rates were forecast to fall. The aim was then to replace these loans in the short to medium term when either:

- the long term PWLB rate fell below 4.0%, or if this was unlikely to happen,;
- spreading the debt maturity pattern over a shorter period to take advantage of lower interest rates in these shorter periods and also to provide more flexibility for debt rescheduling opportunities in the future.

To date, £33.0 million of these loans have been replaced with new loans from the PWLB as detailed in the table below. All loans were below the 4.00% target rate set for long term borrowing and represent a lower cost of borrowing to the Council going forward.

Date	Lender	Amount £m	Period (Years)	Rate %	Benchmark % Rate	Margin %
18/06/09	PWLB	5.0	3.0	2.32	4.00	(1.68)
18/06/09	PWLB	5.0	4.0	2.73	4.00	(1.27)
22/06/09	PWLB	5.0	9.0	3.67	4.00	(0.33)
30/06/09	PWLB	5.0	10.0	3.71	4.00	(0.29)
30/06/09	PWLB	4.0	8.5	3.65	4.00	(0.35)
30/06/09	PWLB	4.0	11.5	3.99	4.00	(0.01)
13/10/09	PWLB	5.0	18.5	3.99	4.00	(0.01)
Total		33.0		3.41		

4.6 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."

The Strategy also stated that because of the proactive approach taken by the Council in recent years, and because of the very low underlying rate of the Council's long term debt, it would be difficult to refinance long term loans at interest rates lower than those already in place.

In January 2010 however, advantage was taken of market conditions, which enabled a debt rescheduling exercise to be undertaken. As a result, £24.0 million of PWLB loans with an average rate of 4.20% (rates ranged from 4.15% to 4.30%) were prematurely repaid. The details of which are shown in the table below.

Date	Lender	Amount £m	Rate %	Premium / (Discount) £
12/01/10	PWLB	4.0	4.15	(46,699)
12/01/10	PWLB	4.0	4.15	(47,065)
12/01/10	PWLB	3.0	4.20	(5,908)
12/01/10	PWLB	3.0	4.20	0
12/01/10	PWLB	3.0	4.20	0
12/01/10	PWLB	3.0	4.30	60,144
12/01/10	PWLB	4.0	4.25	39,816
		24.0	4.20	288

It was considered prudent to repay these PWLB loans and use investments to temporarily finance the transaction. The consequent reduction in investments had a further benefit of reducing the counterparty risk as the Council had fewer funds to place by repaying this debt early. The cost of this rescheduling (£288) was almost cost neutral. However, the action taken will result in an annual net saving of interest of £817,000, until such time as the debt is replaced. As reported to the last meeting of this Committee, the debt has been part replaced as follows:

Date	Lender	Amount £m	Period Years	Rate %
21/05/10	PWLB	10.0	4	1.99*
21/05/10	PWLB	5.0	50	4.29*
		15.0		2.76

* Benchmark borrowing rate 2010/2011 is 4.50%

- 4.7 The Council has nine market Lender's Option / Borrower's Option (LOBO) loans totalling £39.5 million, of which £34.5 million are now flat rate vanilla LOBO's which have three year roll-over periods. This essentially means that these loans have become flat rate loans which are reviewed every 3 years. The other loan of £5.0 million still has a six monthly roll-over period. Details are shown in the table below.

Lender Option Borrower Option – Vanilla arrangements

**This LOBO converted from its original front-end rate of 2.55% to 4.50% on 23rd April 2007, under the terms of the loan.

The Treasury Management team will continue to monitor this loan for an opportunity to renegotiate the loan on more favourable terms, but this is unlikely to happen in the current interest rate environment.

4.8 The Council's borrowing portfolio position at 31st March 2010 was:

Start Date	Lender	Amount £m	Period Years	Rate %	Initial Fixed Period	Roll Over Period	Next Roll Over Date
27/01/06	Dexia	5.0	60	4.32	27/01/09	3 Years	27/01/12
03/02/06	Dexia	5.0	60	4.37	03/02/10	3 Years	03/02/13
22/02/06	Dexia	5.0	60	4.38	22/02/10	3 Years	22/02/13
12/06/06	Barclays	9.5	60	4.37	12/12/08	3 Years	10/12/11
14/08/06	Barclays	5.0	60	4.45	14/08/07	3 Years	14/08/10
30/09/06	Dexia	5.0	60	4.32	29/09/09	3 Years	29/09/12
21/10/03	Barclays	5.0	40	4.50	23/04/07	6 Mths **	23/10/10
Total		39.5					

		Principal (£m)	Total (£m)	Average Rate (%)
Fixed Rate Funding				
	PWLB	107.5		
	Market	29.5		
	Other	0.4	137.4	3.96
Variable Rate Funding				
	PWLB	0.0		
	Market	10.0		
	Temporary/Other	30.9	40.9	1.37
Total Borrowing			178.3	3.37
Total Investments	In House		172.0	1.91
Net Debt			6.3	

Prudential Indicators – 2009/2010

- 4.9 All external borrowing and investments undertaken in 2009/2010 have been subject to the monitoring requirements of the Prudential Code. Under the code, Authorities must set borrowing limits (Authorised Borrowing Limit for External Debt and Operational Boundary for External Debt) and must also report on the Council's performance for all of the other Prudential Indicators, please see 4.10 below for more details.

The statutory limit under section 3(1) of the Local Government Act 2003 (known as the Authorised Borrowing Limit for External Debt) was originally set by the Council for 2009/2010 in total as £333.322m which was detailed as follows:

	£m
Borrowing	331.759
Other Long Term Liabilities	<u>1.563</u>
Total	<u>333.322</u>

The above limit was reviewed but it was considered that the total limit could accommodate the increase arising from the inclusion of PFI schemes and finance leases being brought on to the Balance Sheet which only affected the amount to be shown as Other Long Term Liabilities. The structure of the Authorised Limit thus was revised to show that:

	£m
Borrowing	241.759
Other Long Term Liabilities	<u>91.563</u>
Total	<u>333.322</u>

The Operational Boundary for External Debt for 2009/2010 was initially set at £227.212m. This was increased by Council on 3rd March 2010 to include an element for long-term liabilities relating to PFI schemes and finance leases, which are to be brought on Balance Sheet in accordance with the SORP 2009 and thus needed to be amended and included in the calculation of the operational boundary for 2009/2010.

The revised operational boundary is set out below:

	£m
Borrowing	200.918
Other Long Term Liabilities	<u>91.563</u>
Total	<u>292.481</u>

The Council's maximum external debt in 2009/2010 was £259.569 million (which includes borrowing in respect of other organisations such as Tyne and Wear Fire and Rescue Authority), and is well within both of the above limits.

- 4.10 The table below shows that all other Treasury Management Prudential Indicators have been complied with during 2009/2010, and these are set out in the table overleaf

Prudential Indicators		2009/2010	
		Limit £'000	Actual £'000
P10	Upper limit for fixed interest rate exposure Net principal re fixed rate borrowing / investments	70,000	27,367
P11	Upper limit for variable rate exposure Net principal re variable rate borrowing / investments	30,000	26,867
P12	Maturity Pattern Under 12 months 12 months and within 24 months 24 months and within 5 years 5 years and within 10 years 10 years plus A lower limit of 0% for all periods	Upper Limit 40% 50% 50% 75% 100%	18.18% 0.01% 5.66% 7.90% 81.71%
P13	Upper limit for total principal sums invested for over 364 days	100,000	35,000

4.10 The impact on the borrowing costs of the Council in following its Borrowing Strategy has produced the following effect on the Council's "pool rate" of interest over the last five years as follows

2005/06	4.31%
2006/07	4.58%
2007/08	4.71%
2008/09	4.14%
2009/10	2.89%

The movement in the pool rate reflects long term fixed rate borrowing decisions and the movement in market rates. The Base Rate reduction to 0.5% together with the debt rescheduling carried out by the council and cheaper replacement PWLB loans acquired (see 4.5 above) has resulted in a decrease of 1.25% in the pool rate from 4.14% in 2008/2009 to 2.89% for 2009/2010.

5. Investment Strategy and Performance – 2009/2010

5.1 The Annual Investment Strategy basically sets out the type of investments the Council can use for the purpose of investments and makes specific reference to:

- the procedures for determining the use of each asset class, (advantages and associated risk), particularly if the investment falls under the category of "non-specified investments";

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

5.2 The Annual Investment Strategy has been fully complied with in 2009/2010 with the exception that for a short period of time there were a limited number of departures in respect of section 13.4 of the Annual Investment Strategy which states that "the minimum amount of overall investments that the Council will hold in short-term investments (less than one year) is £50m. As the Council has decided to restrict most of its investments to term deposits, it will maintain liquidity by having a minimum of 50% of these short-term investments maturing within 6 months".

This occurred because of the need to mitigate the risk of the fall in interest rates on investments, which meant more funds were temporarily placed for longer than 6 months in accordance with the approved Lending List and Criteria in order to maximise investment income with what are regarded as very safe and secure institutions which also have the government guarantee in place. This position had no impact upon the Prudential Indicators as reported and was actually beneficial to the council in higher returns on investments than would have been the case otherwise. Also the Annual Investment Strategy was amended to recognise the fact that the 50% limit in 2009/2010 was being unnecessarily restrictive and this was revised to 40% for 2010/2011.

5.3 At 31st March 2010 the Council had outstanding investments of £172.0 million. The table below shows the return made on the Council's total investments for 2009/2010 as compared with the 7 Day rate, which the Council has used historically to assess its performance.

	2009/2010 Return	2009/2010 Benchmark
	%	%
In-house Managed Funds	1.91	0.36

This return far exceeded the benchmark set for 2009/2010 and represents a very good achievement in a year that has seen a great deal of uncertainty and volatility in the financial markets.

5.4 All investments placed in 2009/2010 have been made in accordance with the approved Criteria and the Approved Lending List which was agreed in the 11th February 2009 Cabinet Report and approved by Council on 4th March 2009.

- 5.5 In view of the present economic climate and the current situation with the financial markets the Director of Financial Resources, in consultation with the Cabinet Portfolio holder for Resources, has the delegated authority to vary the Lending List Criteria and Lending List itself should circumstances dictate, on the basis that changes be reported to Cabinet and the Audit and Governance Committee retrospectively, in accordance with normal Treasury Management reporting procedures.
- 5.6 As members will be aware, the regular updating of the Council's Authorised Lending List and Criteria is required in the light of financial institution mergers and changes in institutions' credit ratings. These changes have already been reported to members in detail previously but for information the position as at 31st March 2010 is shown in the attached Appendices, which reflect the limited changes made during the year.
6. **Reasons for Decisions**
- 6.1 To note the performance for 2009/2010.
7. **Alternative Options**
- 7.1 *No alternatives are submitted for Cabinet consideration.*

Background Papers

Sector CityWatch (Monthly) and weekly credit rating list
Sector / Capital Economics / UBS Economic forecasts
Local Government Act 2003
Treasury Management in the Public Services Code of Practice
The Prudential Code for Capital Finance
Audit Commission Risk and Return Report (March 2009)
CIPFA Treasury Management Code of Practice consultation on proposed changes
Revised CIPFA Treasury Management Code of Practice (December 2009)
The Financial Times

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.

Fitch / S&P's Long Term Rating	Fitch Short Term Rating	S&P's Short Term Rating	Moody's Long Term Rating	Moody's Short Term Rating	<u>Maximum Deposit £m</u>	<u>Maximum Duration</u>
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 2.

Approved Lending List

Appendix 2

	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		
UK	AAA	F1+			Aaa			AAA		250	364 days
Lloyds Banking Group (see Note 1)										Group Limit 40	
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
Royal Bank of Scotland Group (See Note 1)										Group Limit 40	
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
Santander Group *										Group Limit 30	
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		Limit £m	Max Deposit Period
	L Term	S Term	Individual	Support	L Term	S Term	Fin Strength	L Term	S Term		
Top 10 Building Societies (by asset size)											
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

