Sunderland City Council

Item No. 7

Audit and Governance Committee **27 November 2009**

Treasury Management - Review of Performance 2008/2009 and Mid Year Review 2009/2010

Report of the Director of Financial Resources

1 **Purpose of the Report**

1.1 To provide a copy of the report on the borrowing and investment performance for 2008/2009 and a review of the Treasury Management Strategy for 2009/2010 that was approved by Cabinet on 7th October 2009.

1.2 In accordance with revised Treasury Management best practice, the Council now reports upon its Treasury Management activities quarterly (from half yearly) and also agreed that it would have these reports scrutinised by both this Committee and Management Scrutiny Committee. This is as such the first report for this Committee to scrutinise and review.

2 **Description of Decision**

2.1 Committee is requested to:
- note the Treasury Management performance for 2008/2009 and to note the progress in implementing the strategy for 2009/2010; and
- note the updated Council lending criteria and list of authorised institutions.

3 **Introduction**

3.1 This report sets out the annual borrowing and investment performance for the financial year 2008/2009, in accordance with the requirements of the Treasury Management Strategy agreed by Council. The report also includes a review of the progress made in implementing the borrowing and investment strategy for the current financial year 2009/2010.

4 **Review of Performance 2008/2009**

Borrowing Strategy and Performance – 2008/2009

4.1 Cabinet agreed the borrowing strategy for 2008/2009 on 13th February 2008. 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 4.50% for long term borrowing;
- take advantage of any debt rescheduling opportunities.

4.2 The borrowing strategy was reviewed in October 2008 and was reaffirmed.

4.3 Bank base rates varied during 2008/2009 and 2009/2010 (to date) 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
March 2009	0.50

The Base Rate began at the start of 2008/2009 at 5.25% and had reduced to 4.50% by October 2008. The 1.50% reduction in November 2008 was part of a co-ordinated international response to reduce interest rates and stabilise world financial markets following the collapse of Lehman Brothers (a bank in the United States). This was followed by a 1.00% reduction in December 2008, and successive monthly cuts of 0.50% from January 2009 to March 2009 to leave the Base Rate at its current level of 0.50% (the lowest level since records began).

The following table sets out the average borrowing rates during 2008/2009:

	2008 / 2009			
Borrowing Rates	**Q1**	**Q2**	**Q3**	**Q4**
	%	**%**	**%**	**%**
7 day notice	5.03	5.00	3.35	1.00
1 year	4.80	4.82	2.34	0.97
5 year	4.83	4.78	3.66	2.72
10 year	5.00	4.90	4.27	3.66
25 year	4.85	4.79	4.57	4.37
50 year	4.53	4.49	4.30	4.38

As the table above shows, the short term interest rates of the Public Works Loan Board (PWLB), the government's lender, reflected the fall in Base Rate, but the 1 year to 5 year rates more closely mirrored the base rate reduction with the longer term interest rates showing less of a reduction.

4.4 The borrowing requirement for 2008/2009 was £5.6 million (as a result of the 11.75% redeemable stock maturing on 23rd November 2008). As interest rates were forecast to fall the decision was taken to monitor rates and replace this debt when the lowest rates of interest could be achieved from the market as appropriate.

4.5 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."

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 (4.10%) 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 2009 advantage was taken of market conditions which enabled a debt rescheduling exercise to be undertaken by the council. As a result £30.0 million of PWLB loans, with rates ranging from 4.15% to 4.30% (details are shown in the table below), were prematurely repaid. This was considered opportune as investment rates were only averaging 1.80% (and were projected to fall even further) and the average rate payable on the PWLB loans was on average 4.20%.

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**

It was therefore considered prudent to repay these PWLB loans using investments to temporarily finance this transaction, at this time, because the net premium involved was also very advantageous, being almost cost neutral. Another reason for undertaking the rescheduling exercise was to reduce the counterparty risk by temporarily using investments to fund the repayment of comparatively expensive debt, which also meant that the council had more flexibility in placing funds which was important because of the economic and credit related conditions at that time.

The debt was initially replaced temporarily with a loan of £20m at a rate of only 1.05% for only 2 weeks to assist with temporary cash flow needs caused by the rescheduling exercise carried out.

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 happen, then by,
- spreading the debt maturity pattern over a shorter period to take advantage of lower interest rates in these periods and also to provide more flexibility for debt rescheduling opportunities in the future.

This action has saved the Council approximately £184,000 in reduced net interest payments in 2008/2009 and is estimated to save the Council over £1 million in the current financial year.

4.6 As stated at paragraph 4.4 above, the borrowing requirement for 2008/2009 was £5.6 million (as a result of the 11.75% redeemable stock maturing on 23rd November 2008). As interest rates were forecast to fall, the Director of Financial Resources has continued to monitor interest rates and will decide upon the appropriate method and timing of the replacement funding in due course when market rates are more favourable. Detailed monitoring of the position will continue in 2009/2010.

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. One 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

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

** 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 2009 was:

		Principal (£m)	Total (£m)	Average Rate (%)
Borrowing				
Fixed Rate Funding	PWLB	98.5		
	Market	34.5		
	Other	0.4	133.4	4.15
Variable Rate Funding	PWLB	0.0		
	Market	5.0		
	Temporary/ Other	30.7	35.7	3.73
Total Borrowing			**169.1**	**4.06**

Prudential Indicators – 2008/2009

4.9 All external borrowing and investments undertaken in 2008/2009 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 paragraph 4.10 below).

The statutory limit under section 3(1) of the Local Government Act 2003 (known as the Authorised Borrowing Limit for External Debt) was set by the Council for 2008/2009 as follows:

	£m
Borrowing	300.134
Other Long Term Liabilities	1.568
Total	301.702

The Operational Boundary for External Debt for 2008/2009 was:

	£m
Borrowing	221.710
Other Long Term Liabilities	1.568
Total	223.278

The Council's highest external debt in 2008/2009 was £201.559 million (which includes borrowing in respect of other organisations such as Tyne and Wear Fire and Rescue Authority), and is well within both of these limits.

4.10 The table below shows that all other prudential indicators have been complied with in 2008/2009.

	Prudential Indicators	**2008/2009**	
		Limit £'000	**Actual £'000**
P10	**Upper limit for fixed interest rate exposure** Net principal re fixed rate borrowing / investments OR:-	50,000	10,382
P11	**Upper limit for variable rate exposure** Net principal re variable rate borrowing / investments OR:-	40,000	31,633
P13	**Upper limit for total principal sums invested for over 364 days**	90,000	80,609

4.11 The impact on the borrowing costs of the Council in pursuit of the borrowing strategy has produced the following effect on the Council's "pool rate" of interest:

1995/96	6.62%	**2002/03**	4.84%
1996/97	6.48%	**2003/04**	4.07%
1997/98	6.97%	**2004/05**	4.56%
1998/99	7.11%	**2005/06**	4.31%
1999/00	6.64%	**2006/07**	4.58%
2000/01	6.37%	**2007/08**	4.71%
2001/02	6.51%	**2008/09**	4.14%

The movement in the pool rate generally reflects the movement in market rates. Although Base Rates reduced drastically in the second half of 2008/2009 this only affected a small portion of the Council's debt and therefore resulted in a decrease of 0.57% in the pool rate from 4.71% in 2007/2008 to 4.14% for 2008/2009.

Investment Strategy – 2008/2009

4.12 The Strategy set out:

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

4.12 The Annual Investment Strategy has been fully complied with apart from section 13.4 which stated "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 funds were placed for longer than 6 months in accordance with the approved lending list and criteria in order to maximise investment income. This action had no impact upon the Prudential indicators and was corrected within a short time frame with no impact on the council's finances.

4.13 The table below shows the return made on the Council's total investments for 2008/2009 as compared with the 7 Day benchmark rate which the Council uses to assess its performance.

	2008/2009 Return %	**2008/2009 Benchmark %**
In-house Managed Funds	5.06	3.60

This return exceeded the benchmark set for 2008/2009 and represents a very good achievement in a year that saw a great deal of uncertainty and volatility in the financial markets.

5 Review of Treasury Management Strategy for 2009/2010

Borrowing Strategy - 2009/2010

5.1 The borrowing strategy for 2009/2010 was reported to Cabinet on 11th February 2009 and approved by full Council on 4th March 2009. The strategy was based upon interest rate forecasts from a wide cross section of City institutions. The report also incorporated the requirements of the CIPFA Prudential Code for Capital Finance, which was implemented on 1st April 2004 in line with Best Practice.

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 to fall in Q2 2009 (i.e. 25 year loans – 3.95% and 50 year loans – 3.85% to 3.90%) and would remain around these 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 can be seen from the table below (showing the average borrowing rates for Q1 and Q2 2009/2010) these longer term rates have been higher than expected and have not dropped to the expected levels anticipated.

2009/2010	Qtr 1 (Apr - June) %	Qtr 2 (up to 31/08/2009) %
7 days notice	0.46	0.38
1 year	0.97	0.99
5 year	2.80	3.04
10 year	3.72	3.91
25 year	4.57	4.51
50 year	4.66	4.51

5.2 The fall in the Base Rate to 0.5% left the Bank of England with no room manoeuvre. Instead, the Bank of England's Monetary Policy Committee (MPC) shifted its focus to increasing the amount of money in the economy by purchasing gilts, corporate bonds and commercial paper. To do so, the Bank has essentially created money – a policy known as 'quantitative easing'. The total now committed to this strategy is £175 billion, or close to 15% of GDP.

Meanwhile, the Government has also focussed on measures to increase the amount of bank lending in the economy. In January 2009, a series of schemes were announced, insuring some or all of banks' loans to small businesses who had found it difficult to access finance. The massive increase in Government spending and the current economic downturn will impact on Local Government.

5.3 The strategy for 2009/2010 was to adopt a pragmatic approach and to respond to any changing circumstances for the benefit of the Council. A benchmark financing rate of 4.00% for long-term borrowing was set for 2009/2010.

5.4 The Borrowing Strategy for 2009/2010 made provision for debt rescheduling but 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.

At this stage, no debt rescheduling has been undertaken as rates have not been considered sufficiently favourable. However, as stated in Section 4.5 above, £30 million of PWLB loans were prematurely repaid in January 2009. To date £28 million of these loans have now been replaced with new loans from the PWLB as detailed in the table below. All loans were below the 4.00% target set for long term borrowing and represents 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)
Total		**28.0**				

The Treasury Management team continues to monitor market conditions and will secure further early debt redemption as and when appropriate opportunities arise. Any rescheduling undertaken will be reported to Cabinet in line with the current Treasury Management reporting procedures.

The strategy for the remainder of 2009/2010 is to continue to monitor interest rates and to take advantage of any debt rescheduling opportunities that may arise.

The Council's treasury portfolio position at 31st August 2009 is set out below:

Borrowing		**Principal (£m)**	**Total (£m)**	**Average Rate (%)**
Fixed Rate Funding	PWLB	126.5		
	Market	34.5		
	Other	0.4	161.4	4.01
Variable Rate Funding	PWLB	0.0		
	Market	5.0		
	Temporary/ Other	30.7	35.7	1.00
Total Borrowing			**197.1**	**3.46**

Prudential Indicators – 2009/2010

5.5 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 report on the Council's performance for all of the other Prudential Indicators.

The statutory limit under section 3(1) of the Local Government Act 2003 (which is also known as the Authorised Borrowing Limit for External Debt) was set by the Council for 2009/2010 as follows:

	£m
Borrowing	331.759
Other Long Term Liabilities	1.563
Total	**333.322**

The Operational Boundary for External Debt was set as shown below: -

	£m
Borrowing	225.649
Other Long Term Liabilities	1.563
Total	**227,212**

The maximum external debt in respect of 2009/2010 (to 31st August 2009) was £197.083 million which is well within the limits set by both prudential indicators.

The table below shows that all other prudential indicators have been complied with.

Prudential Indicators		**2009/2010 (to 31/08/2009) Limit £'000**	**Actual £'000**
P10	Upper limit for fixed interest rate exposure Net principal re fixed rate borrowing / investments	70,000	8,382
P11	Upper limit for variable rate exposure Net principal re variable rate borrowing / investments	30,000	26,867
P13	Upper limit for total principal sums invested for over 364 days	100,000	41,503

Investment Strategy – 2009/2010

5.6 The Investment Strategy for 2009/2010 was approved by Cabinet on 11th February 2009 and set out the objectives as:

- 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).

5.7 The Annual Investment Strategy has been complied with apart from section 13.4 which states "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 briefly in this financial year because of the need to mitigate the risk of the fall in interest rates on investments which meant funds were placed for longer than 6 months in accordance with the approved lending list and criteria in order to maximise investment income transactions placed in the previous financial year. This action however had no impact upon the Prudential indicators and was corrected within a very short time frame with no impact on the council's finances.

5.8 As at 31st August 2009 the funds managed by the Council's in-house team amounted to £188.768 million. The table below shows the return received on these investments as compared with the benchmark rate (i.e. the 7 day rate).

	2009/2010 Actual to date %	**2009/2010 Benchmark %**
Return on investments (to 31st August 2009)	2.12	0.42

5.9 Investments placed in 2009/2010 have been made in accordance with the criteria used to identify organisations for investments as set out in Appendix 1. It was also agreed in the 11th February 2009 Cabinet Report that the Government's AAA credit rating would be applied to UK nationalised banks (or banks where the government have taken a substantial stake). However, the maximum period funds can be placed with these institutions is 364 days, unless a lesser period of guarantee has been stated by the government.

Furthermore, 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 were to be limited to UK institutions only with this position to be kept under review. There are however, residual investments still held in the following countries as at 31st August 2009 which were placed in 2008/2009 before the policy and strategy was changed – which include:

Australia (Country Rating AA+) £5 million National Australia Bank (AA)
Republic of Ireland (Country Rating AA+) £10 million Bank of Ireland (A-)

Once these investments have been returned they will be placed in accordance with the 2009/2010 investment criteria.

5.10 The regular updating of the Council's authorised lending list is required to take into account financial institution mergers and changes in institutions' credit ratings. The Council's lending list includes the top 10 building societies (by asset size). As the Britannia Building Society is no longer a building society, it has now been removed from the list (this follows the merger with the Co-operative Financial Services on 1st August 2009). It has been replaced by the Norwich and Peterborough Building Society which is now the 10th largest Building Society. An updated lending list of the institutions authorised for investments is shown in Appendix 2.

5.11 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.

5.12 In accordance with the revised Treasury Management best practice a risk analysis of the Treasury Management functions has been carried out and included in Appendix 3 for information which sets out how the Council manages the risks involved in the Treasury Management function.

6. Reasons for Decisions

6.1 To note the progress in implementing the Treasury Management Strategy for 2009/2010, which is in line with the approved Treasury Management Policy.

6.2 The updated authorised lending list is reported as this has been updated in the light of financial institution mergers and changes in institutions' credit ratings.

<u>Background Papers</u>

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
Financial Times

APPENDIX 1

LENDING LIST CRITERIA

UK Institutions only

Fitch IBCA Long-term Credit Ratings

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

		£m	Maximum Investment Period
AAA, or AA+	Maximum Investment Limit	30	2 Years
AA	Maximum Investment Limit	25	2 Years
AA-	Maximum Investment Limit	20	364 Days
A+ or A	Maximum Investment Limit	10	364 Days
A-	Maximum Investment Limit	5	6 months

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

	£m	Maximum Investment Period
Local Authorities (limit for each local authority)	30	364 Days

APPENDIX 2

Sunderland City Council

Approved Lending List

This list reflects the changes made since the previous submission to Cabinet on 11th March 2009 to date.

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 / Alliance & Leicester plc	UK	AA-	F1+	Aa3	P-1	20	364 Days
Barclays Bank plc	UK	AA-	F1+	Aa3	P-1	20	364 Days
HSBC Bank plc	UK	AA	F1+	Aa2	P-1	25	2 Years
Lloyds TSB Bank Plc / Bank of Scotland (HBOS)	UK	AA-	F1+	Aa3	P-1	20	364 Days
National Westminster Bank / Royal Bank of Scotland	UK	AA-	F1+	Aa3	P-1	20	364 Days
Northern Rock plc *	UK	A-	F1+	A2	P-1	5	6 Months
* Nationalised - Government guarantee is in place on a rolling 3 month basis							
Top 10 Building Societies							
Nationwide B.S.	UK	AA-	F1+	Aa3	P-1	20	364 Days
Yorkshire B.S.	UK	A-	F2	Baa1	P-2	5	6 Months
Coventry B.S.	UK	A	F1	A3	P-2	10	364 Days
Chelsea B.S.	UK	BBB+	F2	Baa3	P-3	5	N/A
Leeds B.S.	UK	A	F1	A2	P-1	10	364 Days
West Bromwich B.S.	UK	BBB-	F3	Baa3	P-3	5	N/A
Skipton B.S.	UK	A-	F2	Baa1	P-2	5	6 Months
Principality B.S.	UK	BBB+	F2	Baa2	P-2	5	N/A
Newcastle Building Society	UK	BBB-	F3	Baa2	P-2	5	N/A
Norwich and Peterborough B.S.	UK	A-	F1	Baa2	P-2	5	6 Months

N/A – Not Applicable as below the long term rate of A-

APPENDIX 3

Risk Management Review of Treasury Management

Set out below are the risks the Council face as a result of carrying out their Treasury Management functions and the controls that are in place to mitigate those risks:

	Risk	Controls
1.	**Strategic Risk** The Council's strategic objectives could be put at risk if borrowing costs escalated, or investment income was reduced, or there was a combination of the two. This could result in a negative impact on the Council's budget and could ultimately lead to a reduction in resources for front line services.	This risk is mitigated by the adoption of a Treasury Management Strategy approved by the Council in March each year for the next financial year, in accordance with the CIPFA Code of Practice on Treasury Management. The Treasury Management Strategy sets out a borrowing strategy and investment strategy for the year ahead. The strategy is based on the Director of Financial Resources' view on the outlook for interest rates, supplemented by the views of leading market forecasters provided by the Council's treasury advisor (currently Sector). The strategy also sets the Authorised Borrowing Limit (setting the maximum amount that the Council may borrow) and various prudential indicators to ensure the Treasury Management function is monitored and properly managed and controlled.
2.	**Interest Rate Risk** The risk of fluctuations in interest rates affects both borrowing costs and investment income and could adversely impact on the Council's finances and budget for the year.	The Council manages its exposure to fluctuations in interest rates with a view to minimising its borrowing costs and securing the best rate of return on its investments, having regard to the security of capital, in accordance with its approved Treasury Management Strategy. The risk is mitigated due to the prudent view taken on interest rates adopted in the budget after taking into account the Director of Financial Resources' own view of the financial markets, specialist expert advice, other information from the internet, the Financial Times, other domestic and international economic data, published guidance and Government fiscal policy. A pro-active approach is taken by the Council's Treasury Management team, which closely monitors interest rates on a daily basis and takes necessary actions to help mitigate the impact of interest rate changes over the short, medium and longer term as appropriate.

	Risk	Controls
3.	**Exchange Rate Risk** As a result of the nature of the Council's business, the Council may have an exposure to exchange rate risk from time to time. This will mainly arise from the receipt of income or the incurring of expenditure in a currency other than sterling.	All borrowings and investments are made in sterling and are therefore not subject to exchange rate risk. This risk is minimal as all other foreign exchange transactions are automatically converted into GBP sterling by the Council's bankers on the day of the transaction.
4.	**Inflation Risk** There is a risk that the rate of inflation will impact on interest rates as a direct result of the intervention of the Bank of England to control inflation through the use of interest rates, where inflation rates have exceeded or are projected to exceed the target rates agreed between the Bank of England and Government.	Economic data such as pay, commodities, housing and other prices are monitored by the Council's treasury advisors. These are considered as part of an overall view on the influences on inflation rates, which in turn inform the Council's view on interest rate forecasts when drafting annual budgets and reviewing treasury management performance. Regular meetings are held with treasury advisors to provide updates on economic data to monitor any changes in inflation rates that may influence interest rates so that the Treasury Management Strategy can be revised and updated as necessary and any remedial action taken.
5.	**Counterparty Risk** The Credit Crunch and problems encountered by some authorities with Icelandic Banks has demonstrated that there is a risk of losing funds/investments deposited with counterparties when carrying out its investment strategy activities.	The prime objective of the Council's treasury management activity in this area is the security of the capital sums it invests. Accordingly, counterparty lists and limits reflect a prudent view of the financial strength of the institutions where funds are deposited. The Council also only uses instruments set out in its investment policy and places limits upon the level of investment with the Counterparties approved within the Council's Treasury Management Policy and Strategy Statement. The Director of Financial Resources has delegated authority to amend both the Lending Criteria and the Approved Lending List in response to changes in the financial markets should the need arise and these changes are reported to Council at the next available opportunity. The Treasury Management team continually monitor information regarding counterparties using credit ratings, news articles, the internet, the Financial Times, Credit Default Swap

	Risk	Controls
		prices, professional advice and other appropriate sources to formulate its own view to keep the approved lending list up to date and fully informed, using the latest available information.
6.	**Capital Financing and Refinancing Risk** There is a risk that opportunities for rescheduling of the Council's debt portfolio are constrained.	The risk is currently mitigated as the Council has access to the funds of the Public Works Loan Board (PWLB). PWLB funding could come under pressure in future years because of the large and increasing amount of public debt incurred by the Government which could see a return to the operation of the PWLB quota system as operated in previous years where Government funding was restricted.
7.	**Statutory and Regulatory Risk** There is a risk that regulations covering Treasury Management will change and the Council fails to respond to those changes.	The Council ensures full compliance with the current legislative requirements under the Local Government Act 2003 and the Prudential Code, which also requires full compliance with the CIPFA Treasury Management Code of Practice. All Treasury Management Prudential Indicators are monitored daily and all Treasury Management practices fully comply with the Code of Practice (including the recent proposals) and this is reported to and agreed by Council. As a response to the credit crunch and the banking sector crisis, CIPFA has put forward proposals to amend the Treasury Management Code of Practice to strengthen the arrangements adopted by local government in response to the Audit Commission's 'Risk and Return Report – recommendations published on 26th March 2009. The Council has responded positively and proactively to all such changes and the recent report to Cabinet on 3rd June 2009 demonstrates Council practices have been amended to fully comply with the proposals set out by CIPFA.

	Risk	Controls
8.	**Treasury Management Arrangements Risk** There is a risk that the council does not carry out its Treasury Management function effectively and thereby the Council could suffer financial loss as a result.	This is unlikely to happen because the Treasury Management function is required to ensure the Council can comply with all legislative and regulatory requirements. As such the Council has a well established Treasury Management team that operates under the Director of Financial Resources and is staffed appropriately with a good mix of both well experienced and qualified staff. Training and professional advice is regularly carried out to ensure the team is up to date and that they can inform senior management and Members of all developments and provide the necessary expert advice and guidance in this specialist area of finance. Some members of the team are to complete the recently announced new CIPFA Treasury Management qualification for those working in the public sector to further strengthen the knowledge and qualifications of the Treasury Management team.