Cabinet - 16th February 2011

Capital Programme 2011/2012 and Treasury Management Policy and Strategy 2011/2012, including Prudential Indicators for 2011/2012 to 2013/2014.

Report of the Executive Director of Commercial and Corporate Services

1. Purpose of the Report

1.1 To update Cabinet on the level of capital resources and commitments for the forthcoming financial year and seek a recommendation to Council to the overall Capital Programme 2011/2012 and the Treasury Management Policy and Strategy (including both borrowing and investment strategies) for 2011/2012 and to set the Prudential Indicators for 2011/2012 to 2013/2014.

2. Description of Decision

Cabinet is requested to recommend to Council approval of:
- the proposed Capital Programme for 2011/2012;
- the Annual Treasury Management Policy and Strategy (including specifically the Annual Borrowing and Investment Strategies);
- the prudential indicators for 2011/2012 to 2013/2014;
- the Annual Minimum Revenue Provision Statement for 2011/2012.

3. Capital Programme 2011/2012

General

3.1 The proposed Capital Programme for 2011/2012 totals £76.228 million and reflects ongoing capital scheme commitments from previous years of £39.392 million, slippage of £10.800 million from 2010/2011 and new starts of £26.036 million. The details of the full Capital Programme for 2011/2012 are included as Appendix 2 and the proposed new starts are set out in Appendix 1 which the rest of this section of the report covers in more detail.

Resources Available for new Starts

Resources - Grants

3.2 As reported to Cabinet in January 2011 resources have been allocated for the main programme areas of Children's Services, Adult Services, Highways, and Housing on the basis of their specific government funding approvals and other service specific resources. The table below details new Government Grants announced for 2011/2012 onwards.

	2011-12 £000s	**2012-13 £000s**	**2013-14 £000s provisional**	**2014-15 £000s provisional**
Highways Capital Maintenance	2,804	2,919	2,877	2,768
Highways Integrated Transport	2,008	2,141	2,141	3,011
Total Transport	**4,812**	**5,060**	**5,018**	**5,779**
Education Capital Maintenance	3,979			
Education Basic Need	3,308			
Total Education*	**7,287**			
Department of Health	**829**	**845**		
Total Government Grants	**12,928**	**5,905**	**5,018**	**5,779**
*In addition the Department for Education has announced funding of £2.051m for which schools will have direct responsibility.				

The above table shows significantly reduced grants of over 50% compared to previous years, which have been considered in drafting of proposals for future years capital programmes submitted by Directorates. The Council is still awaiting details of future years grant funding in a number of areas such as Major Transport Schemes and an indicative allocation of £1.097m for 2011/2012 and £0.845m for 2012/2013 has been received in respect of Disabled Facilities Grants.

Any further grant approvals which are received will be reported to Cabinet as part of the regular capital programme reviews during the year together with any proposals for additional schemes as appropriate.

Resources – Capital Receipts

3.3 Due to the effects of the economic downturn and the fact that the housing market is still depressed, economic recovery is expected to continue to be slow. As a result, very few capital receipts have been, or are anticipated to be received in 2010/2011 or in 2011/2012.

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

Resources – Other

3.4 To support the Other Services Block new starts an assessment has been made of the capital programme and a range of potential sources of funding including:

- Revenue Budget and potential Savings;
- Reallocation of existing reserves.

After reviewing the above and taking into account capital commitments, resources available to support new starts at this stage total £4.470 million for 2011/2012 and £2.570 million for 2012/2013.

In addition there are a number of projects which are eligible for funding through prudential borrowing on either an 'invest to save' basis or in order to enable strategic priorities of the Council to proceed. The proposed revenue budget includes prudent provision for capital financing charges that may arise from an additional £10.057 million of prudential borrowing in 2011/2012 and £11.700 million in 2012/2013. The revenue budget is framed to enable such levels to be affordable and sustainable into future years.

Detailed Proposals for New Starts and Capital Programme 2011/2012

3.5 Since the January 2011 Cabinet meeting, consultation with the appropriate Cabinet Portfolio Holders has been undertaken on the proposals to utilise the resources available for new starts. Account was taken of the priorities set out in the Sunderland Economic Masterplan and also the outcome of budget consultations. Details of proposed new capital projects are detailed in Appendix 1. The recommended Capital Programme is included in full as Appendix 2 to this report.

Further Reports

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

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

4. **Prudential Framework and Code**

4.1 One of the principal features of the Local Government Act 2003 was to provide the primary legislative framework to introduce a prudential regime for the control of Local Authority capital expenditure. The regime relies upon both secondary legislation in the form of regulations, and a prudential code issued and maintained by the Chartered Institute of Public Finance and Accountancy (CIPFA). The Prudential Code was reported to Council in March 2004.

4.2 Under the prudential framework local authorities are free to borrow without specific government consent if they can afford to service the debt without extra government support. The basic principle is that authorities are free to invest as long as their capital spending plans are affordable, sustainable and prudent. This allows the Council the freedom to manage and control its capital programme and how it is financed. The key elements of control and management of capital finance are through:

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

4.3 All authorities must follow the prudential code published by CIPFA. This involves setting various prudential limits and indicators that must be approved by the Council before the start of the relevant financial year as part of their budget setting process. The prudential and treasury management indicators have been prepared for the financial year 2011/2012, taking into account all matters specified in the code. Regular monitoring will take place during the year and reports made to Cabinet to show the council's performance and compliance with these indicators as part of the quarterly capital review reports as appropriate.

4.4 All of the indicators together with background information to these indicators and what they are seeking to assess, are detailed in Appendix 3 in full compliance with the code.

4.5 In addition regulations came into force on 31st March 2008 revoking secondary legislation to make a Minimum Revenue Provision (MRP) charge to the revenue account for the repayment of debt associated with expenditure incurred on capital assets. The legislation was replaced with a new duty for local authorities to set, each year, an amount of MRP it considers prudent. It also recommends that an annual statement of its policy on making a MRP in respect of the following financial year is submitted to full Council for approval.

4.6 The recommended Minimum Revenue Provision Statement for 2011/2012 for the Council is set out in Section 6.11 a) to d) of Appendix 4.

5**.** **Treasury Management**

5.1 Treasury management is defined as "the management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

5.2 **Statutory requirements**

The Local Government Act 2003 (the Act) requires the Council to adopt a Treasury Management Policy Statement (detailed in Appendix 5) and to set out its Treasury Management Strategy comprising the Council's strategy for borrowing and the Council's policies for managing its investments, and giving priority to the security and liquidity of those investments (Appendix 6).

The Department of Communities and Local Government issued revised investment guidance which came into effect from 1 April 2010. There are no major changes required over and above the arrangements that the Council already has in place and were included in the revised CIPFA Treasury Management Code of Practice 2009 that the Council fully adheres to.

5.3 **CIPFA requirements**

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) was adopted by this Council on 3rd March 2010.

The primary requirements of the Code are as follows:

1. The Council will create and maintain, as the cornerstones for effective treasury management:
   - a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities;
   - suitable Treasury Management Practices (TMP's), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

   The content of the policy statement is detailed in Appendix 5 and the TMP's follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of the Council. Such amendments which are minor in nature do not result in the Council deviating from the Code's key principles however.

2. The Council will receive reports on treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMP's.

3. The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and for the execution and administration of treasury management decisions to the Executive Director of Commercial and Corporate Services, who acts in accordance with the organisation's Policy Statement, TMPs and CIPFA's Standard of Professional Practice on Treasury Management.

4. The Council has previously nominated the Audit and Governance Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

5.4 **Treasury Management Strategy for 2011/2012**

5.4.1 The Treasury Management Strategy comprises a Borrowing and an Investment Strategy. These set out the Council's policies for managing its borrowing and investments and for giving priority to the security and liquidity of investments.

5.4.2 There are no major changes being proposed to the overall Treasury Management Strategy in 2011/2012 which maintains the careful and prudent approach adopted by the Council in previous years. Particular areas that inform the strategy include the extent of potential borrowing included in the Council's capital programme, the availability of borrowing, and the current and forecast global and UK economic position, in particular forecasts relating to interest rates and security of investments.

5.4.3 The proposed Treasury Management Strategy Statement for 2011/2012 is set out in Appendix 6 and is based upon the views of the Executive Director of Commercial and Corporate Services, supplemented with market data, market information and leading market forecasts provided by the Council's treasury adviser, Sector Treasury Services.

5.4.4 The strategy is subject to regular review to ensure compliance to the agreed treasury management strategy and that the strategy adapts to changing financial markets as appropriate. It is pleasing to note that the Council's current average rate of borrowing at 3.35% is low in comparison with other local authorities whilst the current rate earned on investments at 1.49% is higher than the benchmark rate. In addition debt rescheduling undertaken by the Council has achieved significant savings in interest charges and discounts and these interest savings have been secured for many years to come. For example, since November 2008 the Council has rescheduled debt worth £59.5 million with an ongoing reduction in interest costs of just under £1.0 million per annum. Market conditions are under constant review so that the Council can take a view on the optimum time to carry out further borrowing or debt rescheduling.

6. Suggested Reason for Decision

6.1 To comply with statutory requirements.

7. Alternative Options

7.1 No alternatives are submitted for Cabinet consideration

Background Papers

Various Notifications regarding Capital Resources for 2011/2012
Sector City Watch (Monthly)
Local Government Act 2003
The Prudential Code for Capital Finance in Local Authorities
Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes (Fully Revised Second Edition 2009)
Treasury Management in the Public services Guidance Notes for Local Authorities including Police Authorities and Fire Authorities (Fully Revised Third Edition)

Appendix 1

Capital Programme 2011/2012 – New Starts

1.0 **Children's Services Capital Proposals 2011/2012**

1.1 The Secretary of State for Education, Michael Gove announced details of schools capital funding for 2011/2012 as part of the Local Government Finance Settlement on 13th December 2010.

Detail of the grant allocations for Sunderland are set out in the table below.

	2010/2011 Original Allocation £'000	2010/2011 Revised June Allocation £'000	2011/2012 Allocation £'000
Education – LA Block			
Primary Capital Grant	6,470	6,470	0
Modernisation	2,923	2,923	0
Capital Maintenance	0	0	3,979
Extended Schools	256	117	0
Basic Need	865	865	3,308
Schools Access Initiative	513	513	0
Harnessing Technology	1,042	519	0
	12,069	**11,407**	**7,287**
Schools Block			
Local Authority Devolved Formula Capital (Standards Fund)	4,076	4,076	770
Local Authority Voluntary Aided Devolved Formula Capital (Standards Fund)	1,068	1,068	222
Local Authority Co-ordinated Voluntary Aided Programme	1,371	1,371	1,059
	6,515	**6,515**	**2,051**
Other			
Children's Social Care	50	50	0
Youth Capital Fund Grant	174	87	0
Sure Start, Early Years and Childcare Grant	1,050	1,050	0
	1,274	**1,187**	**0**
All Capital Approvals	**19,858**	**19,109**	**9,338**

1.2 **Proposals for Children's Services Capital Programme New Starts 2011/2012**

1.2.1 In 2011/12 Sunderland City Council will be allocated £3.308 million in Basic Need funding and £3.979 million for Capital Maintenance.

1.2.2 Education Capital has been severely reduced with a 60% reduction nationally compared to 2010/11 funding levels (largely due to the demise of Building Schools for the Future). The allocation has been provided for 2011/12 only, pending the outcome of the James Review commissioned by the Coalition Government and due to report later this year.

1.2.3 Basic Need (BN) funding will provide new school places where needed and must cover the needs of maintained and voluntary aided (VA) schools. There is no requirement for new places in community schools (or academies) at present given continuing levels of surplus places but the Council will need to discuss a pro-rata share of this funding with the Dioceses and potentially Academy Trusts. As neither BN or Capital Maintenance funds are ring fenced it is proposed to treat both allocations as a single sum to address urgent maintenance priorities in secondary non-BSF schools and primary schools.

1.2.4 The Asset Management Plan identifies significant levels of capital maintenance necessary. This work includes the replacement of life-expired boiler plant, water systems, infrastructure, roofing and windows. The estimated cost for Priority 1 work in secondary schools is £2.838 million and in primary schools this is £2.833 million.

1.2.5 The priority for Children's Services is health and safety, keeping buildings wind and watertight, and thereby avoiding school closures. A contingency sum is therefore also required to address the numerous ad-hoc situations that arise in schools year on year.

1.2.6 The Council also has statutory responsibilities in relation to Health and Safety in schools which must be funded through capital maintenance budgets. It is proposed to undertake a comprehensive programme in 2011/2012 in relation to legionella prevention.

1.2.7 For a number of years Children's Services has relied upon temporary borrowing in lieu of capital receipts to support investment in new school builds. This is not sustainable moving forward and £1.000 million is to be repaid from 2011/2012 funding allocations with £0.250 million allocated on an ongoing basis until repayments have been made (pending further government announcements concerning future capital allocations).

1.2.8 In addition Devolved Formula Capital grant, allocated to schools, will reduce by 75% in 2011/12. A typical secondary school will now receive approximately £25,000 with a typical primary school receiving around £6,000 - £7,000 per year to address maintenance priorities or to upgrade ICT stock.

Appendix 1

2.0 Highways Capital Proposals 2011/2012

2.1 The table below details new Government Grants announced by the Department for Transport for 2011/2012 onwards.

	2010-11 £000s	2011-12 £000s	2012-13 £000s	2013-14 £000s provisional	2014-15 £000s provisional
Highways Capital Maintenance	4,729	2,804	2,919	2,877	2,768
Highways Integrated Transport	2,658	2,008	2,141	2,141	3,011
Maintenance – Named Bridges	243				
Total Transport	**7,630**	**4,812**	**5,060**	**5,018**	**5,779**

2.1.1 The total allocations represent a reduction of 37% on the revised 2010/2011 allocations (43% reduction on the original 2010/2011 allocations). The reduction is greater than for other Tyne and Wear authorities as in 2010/2011 Sunderland received an additional ‘dampening’ allocation to ensure that grant received was not less that 75% of the grant received in the previous year. This ‘dampening’ has ended in 2011/2012.

2.2 **Proposals for Highways Capital Programme New Starts 2011/2012**

2.2.1 Both the Highways Capital Maintenance and Integrated Transport funding blocks are calculated through a needs-based formula and in Metropolitan Areas will now be allocated to the Integrated Transport Authority (ITA) in that area. It is up to the ITA to distribute funds to constituent authorities in their area. At its meeting on 27th January 2011 the Tyne and Wear ITA ratified that the distribution of funds to the Tyne and Wear districts would be distributed by the same allocation methods used in previous years.

Whilst the LTP funding source is not ring fenced should the Council decide to use funding for non-transport capital schemes, then future years allocations from Tyne and Wear ITA may be at risk.

2.2.2 The proposed capital programme for future years, including ongoing commitments, will support the following priorities

To support economic development and regeneration by:-

- maintaining our highways including the completion works to Penshaw Bridge and undertaking works to Lambton Interchange Bridge (A195)
- managing congestion

To address climate change by:-

- promoting sustainable travel, including the introduction of a parking management scheme at the Royal Hospital
- providing low carbon vehicle infrastructure by completing the installation of electric vehicle charging points in public car parks

To support safe and sustainable communities by:-

- improving road safety, including the introduction of the initial 20 mph zone in residential streets
- improving access

Appendix 1

Capital Scheme	**£000s**
Ongoing commitments	2,859
Supporting Economic Development and Regeneration	167
Supporting Safe and Sustainable Communities	1,786
	4,812

Appendix 1

3.0 **Health, Housing and Adult Services Capital Proposals 2011/2012**

3.1 In 2010/2011 the Council received £0.429 million for Adult Services. Under new arrangements that consolidate various funding streams, capital grant funding from the Department of Health (DoH) has been maintained nationally at 2010/2011 levels and will rise in line with inflation. Councils will receive DoH capital grant on the basis of social care Relative Needs Formula, rather than the bidding process for various grants that has been used in the past. The allocation to Sunderland is £0.829 million in 2011/2012 and £0.845 million in 2012/2013 and should be used to support three key areas which comprise of personalisation, reform and efficiency.

3.2 Housing funding in previous years has been made available through the Single Housing Investment Plan (SHIP) provided by the Regional Housing Board. The Council received £1.687 million in 2010/2011 however notification has been received of the cessation of the regional pot for SHIP funding from 2011/2012. The Department for Communities and Local Government announced in the Spending Review that they will protect their element of Disabled Facilities Grant funding, while removing the ring fence. Further details of the grant award to Sunderland are awaited, although nationally the allocation has increased from £1.688 billion in 2010/2011 to £1.800 billion in 2011/2012.

3.3 **Proposals for Health, Housing and Adult Services Capital Programme New Starts 2011/2012**

The following projects are proposed for inclusion in the 2011/2012 capital programme:

3.3.1 **Housing**

Disabled Facilities Grant
It is proposed that Disabled Facilities Grants scheme is continued in 2011/2012 and funded through the a specific government grant of £1.097 million (indicative allocation), a Council contribution of £0.570 million, a Directorate revenue contribution of £0.301 million, a contribution from Registered Social Landlords of £0.130 million and DoH funding of £0.300 million (indicative allocation) amounting to a total new programme of £2.398 million.

Housing Renovation Loans Scheme
The Loans Scheme has in previous years been funded from SHIP resources. This funding stream has now ceased and in order to continue the scheme the regional partnership will be submitting a bid to the Regional Growth Scheme via 5 Lamps (the scheme administrators). Should the bid be successful the Council will need to make a financial contribution of £0.100 million per annum for 3 years.

3.3.2 **Adult Services**

Refurbishment Works
Annually the Directorate reviews all establishments including those occupied by clients and a schedule of refurbishment works totalling £0.312 million has been identified to ensure that they are maintained at an acceptable level. This includes a contribution towards the relocation of Sunderland Carers Centre to premises within Thompson Park and an existing commitment for works to the café at Herrington Park which once complete will become a social enterprise providing a place of employment for clients with learning disabilities.

IT Schemes
An allocation of £0.044 million is proposed to support various IT schedules of work that are required, following consultations, to ensure that current systems support the modernisation agenda.

Appendix 1

Extra Care

It is proposed £0.540 million is allocated towards extra care, allowing the council to contribute towards enabling the provision of housing solutions for older households in the city. It will enable the provision of more reablement opportunities, maximising referrals into appropriate self contained accommodation and supporting independent living for longer with the provision of care and support tailored to the needs of the individual.

Summary of Capital Proposals

	Department of Health £'000	**B/Fwd Directorate Resources £'000**	**TOTAL £'000**
Housing Renovation Loans Scheme	17	83	100
Refurbishment Works	312		312
IT Schemes		44	44
Extra Care	500	40	540
	829	**167**	**996**

Appendix 1

4.0 **Other Services Capital New Start Proposals 2011/2012**

The following new projects are proposed for inclusion in the 2011/2012 capital programme:

4.1 **Economic Development Block Provision – £0.800 million**
The proposal seeks to continue the policy of providing funding for a range of capital projects and job creation and retention initiatives that support economic development and regeneration objectives in the city in accordance with the Economic Masterplan. The fund provides a resource to deal with unforeseen demands on both the revenue and capital budgets, and covers both strategic investments in infrastructure and facilities for business and direct support to business growth and investment activities, particularly where new job creation will result.

4.2 **City Centre 'Quick Wins' (including Fawcett Street Public realm) £1.000 million**
It is proposed to continue the programme commenced in 2009 to demonstrate the Council's commitment to the City Centre and to support businesses during the economic downturn. Programme of support includes Street Scene Improvements; Festivals and Events; Marketing and Promotion; and business support measures.

Following the quick wins street scene project and market square public realm in the City Centre further works to Fawcett Street will deliver the next phase of investment in the city centre public realm.

4.3 **Advanced Site Works £2.000 million (£1.000 million in 2011/2012 and in 2012/2013)**
This is works to a key strategic site in the Economic Master Plan to support economic development and regeneration.

4.4 **Spatial Retail Work £0.120 million**
It is recommended that a contingency is established to procure specialist retail advice to assist the Council to consider planning developments to aid effective decision making.

4.5 **World Heritage Site Public Realm £1.700 million (£0.250 million in 2011/2012 and 2012/2013, and £0.400 million, per annum in 2013/2014 to 2015/2016)**
As part of the bid to secure World Heritage Status for St Peter's Church, this funding will deliver the landscape vision that supports the nomination document. The Council has made a commitment in the management plan to carry out public realm works on this site. Overall expenditure details are subject to review.

4.6 **Network Upgrade £0.030 million**
The last major upgrade of the corporate network was undertaken in 2005. The devices that were installed 5 years ago are coming to the end of their life and require replacing to ensure the corporate network continues to be protected for power failures.

4.7 **Telephony Upgrade £0.077 million**
The current digital telephone system (Avaya VOIP) was installed in 2006 and support for the system will be removed by the supplier in 2011. There is a requirement to upgrade the telephony system which will provide additional functionality and support smarter working. The total cost for the telephony system upgrade will be £0.200 million with £0.123 million available from existing budgets.

4.8 **Strategic Acquisitions £4.000 million**
The physical regeneration of the City is dependent upon the ability of the Council to intervene in the market and where necessary to assemble strategically important parcels of

land that can contribute to the delivery of regeneration projects. It is proposed that a sum of £4.000 million is allocated to fund land acquisitions in accordance with the Council`s policy and with the aims and objectives of the Economic Masterplan. Proposals for acquisition will be brought forward in accordance with the requirements of the Council`s policy.

4.9 **Highways Maintenance £0.300 million**

It is proposed that funding is allocated to carry out work needed to address structural damage caused to highways following the severe winter conditions. The supplementary budget requested assumes no one-off funding will be available from central government.

4.10 **Capital Contingencies**

Resources have been provisionally allocated as a capital contingency to a number of outline schemes which it is intended will be brought forward subject to the consideration of the individual business case. These schemes support the Council's key priorities in terms of regeneration plans and strategic priorities and include

- 'invest to save' schemes to support property rationalisation, smarter working and other process improvements that will help to deliver the efficiency savings required to further the business transformation agenda
- major IT infrastructure projects such as working with partners on a £40m Regional Growth Fund bid to deliver superfast broadband citywide
- other major regeneration and transport capital works within the City that will support the five Aims of the Sunderland Economic Masterplan

Prudential and Treasury Indicators 2011/2012 to 2013/2014

It should be noted that all of the prudential indicators fully reflect the requirements of International Financial Reporting Standards (IFRS) which were introduced from 1st April 2010. Should any of the Council's prudential indicators be exceeded during the year then they will be reported to Cabinet and where appropriate full Council at the next appropriate meeting following the change.

The indicators that must be taken into account are set out below:

P1 Actual capital expenditure incurred in 2009/2010 was £99.921 million and the estimates of capital expenditure to be incurred for the current and future years that are recommended for approval are:

	2010/11 **£'000**	**2011/12** **£'000**	**2012/13** **£'000**	**2013/14** **£'000**
^**Estimated Capital Expenditure**	70.298	76.228	29.437	14.324

An estimate has been made of future spend on the basis of indicative grants approved for 2011/2012 onwards. The profile of expenditure will be updated in the quarterly capital reviews to Cabinet as further projects are approved.

P2 Estimates of the ratio of financing costs to net revenue stream for the current and future years, and the actual figures for 2009/2010 are:

Ratio of financing costs to net revenue stream

2009/2010 Actual	**2010/2011 Estimate**	**2011/2012 Estimate**	**2012/2013 Estimate**	**2013/2014 Estimate**
5.74%	6.01%	7.86%	9.42%	9.70%

The estimates of financing costs include current commitments and the proposals in the revenue budget and capital programme reports. The forecasts show an increase in anticipated ratios of financing costs to net revenue stream in future years as a result of forecast reductions in future years Formula Grant allocations and additional prudential borrowing proposed in the capital programme.

The indicators also show an increase reflecting the fact that significant amounts of expenditure are planned to be financed from earmarked reserves which will lead to investment levels reducing over time and due to forecasted low levels of interest rates as a result of the economic downturn, the end of which is uncertain. It should be noted that the ratios will vary depending on the interest rate obtained on investments and the level of investments available. If there is, for example, slippage in the use of prudential borrowing to fund the capital programme then the ratios shown in the table above will decrease, whilst any reduction in the interest

rate obtained on investments, beyond that estimated, will lead to an increase in the reported ratios.

The level of financing costs is considered to be affordable and has been taken into account when assessing the Medium Term Financial Strategy.

P3 Estimates of the end of year Capital Financing Requirement for the Council for the current and future years and the actual Capital Financing Requirement at 31st March 2010 are:

Capital Financing Requirement

31/03/10 £000 Actual	**31/03/11 £000 Estimate**	**31/03/12 £000 Estimate**	**31/03/13 £000 Estimate**	**31/03/14 £000 Estimate**
238,563	241,771	266,660	273,981	277,283

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

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 used 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 2009/2010, nor are there any difficulties envisaged for the current or future years. This view takes into account current commitments, existing plans, and the proposals in this report and the report elsewhere on today's agenda on the Revenue Budget and Proposed Council Tax 2011/2012.

The Council's net borrowing at 31st March 2010 was £12.591 million and as noted in Prudential Indicator P7 the Council's actual external borrowing was £178.273 million. This variation between actual and net borrowing reflects the cash flow position of the authority and balances held in earmarked reserves. The gap will reduce over time as earmarked reserves are used to fund specific projects as planned.

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

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

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

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

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

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

	Authorised Limit for External Debt			
	2010/2011	**2011/2012**	**2012/2013**	**2013/2014**
	£000	**£000**	**£000**	**£000**
Borrowing	323,990	331,539	340,096	347,623
Other long term liabilities	91,558	50,860	48,710	46,515
Total	**415,548**	**382,399**	**388,806**	**394,138**

The Executive Director of Commercial and Corporate Services reports that these authorised limits are consistent with the Authority's current commitments, existing plans and the proposals in this report for capital expenditure and financing, and with its approved treasury management policy statement and practices. The Executive Director of Commercial and

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

In taking its decisions on the Revenue Budget and Capital Programme for 2011/2012, the Council is asked to note that the authorised limit determined for 2011/2012, (see P5 above), will be the statutory limit determined under section 3(1) of the Local Government Act 2003.

P6 The Council is also asked to approve the following operational boundary for external debt for the same time period and agrees the continuation of the previously agreed limit for the current year since no change to this is necessary. The proposed operational boundary for external debt is based on the same estimates as the authorised limit, but reflects directly the estimate of the most likely, prudent but not worst case scenario level, without the additional headroom included within the authorised limit to allow for example for unusual cash movements, and equates to the maximum of external debt projected by this estimate. The operational boundary represents a key management tool for in year monitoring. Within the operational boundary, figures for borrowing and other long-term liabilities are separately identified. The Council is also asked to delegate authority to the Executive Director of Commercial and Corporate Services, within the total operational boundary for any individual year, to effect movement between the separately agreed figures for borrowing and other long term liabilities, similar to the authorised limit set out above.

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

	Operational Boundary for External Debt			
	2010/11	**2011/12**	**2012/13**	**2013/14**
	£000	**£000**	**£000**	**£000**
Borrowing	235,743	261,603	276,335	291,258
Other long term liabilities	91,558	50,860	48,710	46,515
Total	**327,301**	**312,463**	**325,045**	**337,773**

P7 The Council's actual external debt at 31st March 2010 was £178.273 million.

The Council includes an element for long-term liabilities relating to PFI schemes and finance leases in its calculation of the operational and authorised boundaries to allow further flexibility over future financing. It should be noted that actual external debt is not directly comparable to the authorised limit and operational boundary, since the actual external debt reflects the position at any one point in time and allowance needs to be made for cash flow variations.

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

	For Band D Council Tax	
2011/2012	**2012/2013**	**2012/2013**
£5.24	£24.87	£39.45

The estimates show the net revenue effect of all capital expenditure from all schemes commencing in 2011/2012 and the following two financial years. The impact on the Band D Council Tax detailed above takes account of estimated government grant funding through General Grants.

These forward estimates are not fixed and do not commit the Council. They are based on the Council's existing commitments, current plans and the capital plans detailed in this report. The cumulative effect of full year debt charges will have an additional impact of £39.53 in 2013/2014. There are no known significant variations beyond the above timeframe that would result from past events and decisions or the proposals in the budget report.

P9 The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This original 2001 Code was adopted on 20th November 2002 by full Council and the revised Code was adopted on 3rd March 2010.

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

(a) capital expenditure plans are <u>affordable;</u>

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

(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) <u>accountable</u>, by providing a clear and transparent framework.

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

(e) local strategic planning;

(f) local asset management planning;

(g) proper option appraisal.

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

CIPFA Treasury Management in the Public Services Code of Practice - Indicators 2011/2012 to 2013/2014

P10 It is recommended that the Council sets an upper limit on its fixed interest rate exposures of £105 million in 2011/2012, £125 million in 2012/2013 and £145 million in 2013/2014.

P11 It is further recommended that the Council sets an upper limit on its variable interest rate exposures of £60 million in 2011/2012, £60 million in 2012/2013 and £50 million in 2013/2014.

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

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

	Upper limit	Lower limit
Under 12 months	50%	0%
12 months and within 24 months	60%	0%
24 months and within 5 years	80%	0%
5 years and within 10 years	100%	0%
10 years and within 20 years	100%	0%
20 years and within 30 years	100%	0%
30 years and within 40 years	100%	0%
40 years and within 50 years	100%	0%
over 50 years	100%	0%

P13 A maximum maturity limit of £100 million is set for each financial year (2011/2012, 2012/2013 and 2013/2014) for long term investments, (those over 364 days), made by the authority. This gives additional flexibility to the Council in undertaking its Treasury Management function. Should the Council appoint any external fund managers during the year, these limits will be apportioned accordingly. The type of investments to be allowed are detailed in the Annual Investment Strategy (Appendix 6).

Appendix 3

At present the Council has £0.836 million of long-term investments. This is £0.816 million for the value of share capital held in NIAL Holdings PLC. This equates to a 9.41% share in Newcastle International Airport. The Council also holds £0.020 million in government securities, other shares and unit trusts.

Minimum Revenue Provision Policy Statement 2011/2012

The Department for Communities and Local Government (DCLG) has provided statutory guidance on the methodology to use, which local authorities 'must have regard to'. The guidance recommends that authorities must submit to full Council an annual statement of its policy on making a MRP in respect of the following financial year and highlight which of the various options set out in their guidance will be followed.

6.1 Provision for the repayment of debt is considered to be prudent where the period of repayment is either reasonably commensurate with that over which the capital expenditure to which it relates provides benefits, or in the case of borrowing supported by government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant. The major proportion of the MRP for 2011/12 will relate to the supported historic debt liability.

6.2 The four options for calculating MRP which were set out in the guidance can be summarised as follows:

- Option 1 – Regulatory Method: applying the statutory formula set out in the 2003 Regulations before it was revoked in 2008.
- Option 2 – Capital Financing Requirement (CFR) Method: multiplying the CFR at the end of the preceding financial year by 4%.
- Option 3 – Asset Life Method: amortising expenditure over an estimated useful life for the relevant assets created. An assessment must be made of the asset life at the outset of the capital scheme and MRP is charged to revenue in either equal annual instalments or by an annuity method over the estimated life of the asset. The MRP charge will commence in the financial year following the one in which the asset comes into service.
- Option 4 – Depreciation Method: making charges to revenue in accordance with the standard rules for depreciation accounting for the particular asset being created or enhanced.

6.4 Estimated life periods will be determined under delegated powers. As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, such as IT infrastructure, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives. The Council also reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

6.5 For 2011/2012, having considered all of the options available to the Council, it is proposed that the Council use Option 1 (the Regulatory Method) for government supported borrowing. This is a continuation of the method currently used by the Council (using regulations 28 and 29 of the Capital Finance Regulations and the Local Government Act 2003) where MRP is calculated with regard to the ‘credit ceiling’ of the authority. This takes into account all loan advances and repayments through the Council’s consolidated advances and borrowing pool with MRP being calculated at 4% of the opening ‘credit ceiling’ balance.

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

6.6 Neither of the two options recommended for future borrowing, for which no government support is being given and is therefore self-financed (options 3 and 4), reflect existing Council policy to accelerate debt repayments on unsupported borrowing through an increased voluntary MRP. The depreciation method for calculating MRP is also subject to volatility when asset lives are reassessed as part of the revaluation process.

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

- In the case of invest to save schemes MRP is based on the payback period for any borrowing taken out up to a maximum of 7 years (this requirement is relaxed where unsupported borrowing is taken out on behalf of trading services and areas which are subject to market pressures to ensure that these services would not be put at an unfair disadvantage in comparison to any potential competitors);
- In cases where a full option appraisal shows borrowing to offer better value for money than leasing, MRP is based on the payment period that would have arisen had a lease been taken out instead of a loan;
- In the case of any form of grants for capital purposes that have been given in earlier years and any new grants given for which borrowing is taken out, MRP is based on the actual principal repayment schedule relating to the grant provided. This option is used for existing loans provided to Wearside College, mortgages provided in earlier years to householders under Right to Buy regulations, and loans to industry to support economic regeneration:

In the all other cases where unsupported borrowing is used to finance capital schemes then the option 3 asset life method of determining MRP is used.

6.8 Given budget pressures, it is proposed that opportunities for utilising the prudential framework be restricted to a level where provision has been made within the revenue budget and where the expenditure will either be used to support the Council’s key priorities in terms of regeneration plans and strategic priorities, to fund invest to save schemes, or to support asset purchases where option appraisal of funding through borrowing instead of leasing is appropriate. The revenue budget is framed to enable such levels to be affordable and sustainable into future years.

6.9 For the purposes of the proposed regulations Option 3 is recommended for self-financed borrowing as this method is subject to less potential variation than Option 4. It is also recommended to continue existing practice so that an additional voluntary MRP repayment will be made using the criteria detailed in 6.7 above.

6.10 In addition, revised accountancy guidelines to comply with IFRS have been introduced for the financial year 2010/2011. The new standards have the effect of reclassifying operational leases, finance leases and PFI contracts and require these assets to be brought onto the Council's balance sheet. It is recommended that the MRP policy for 2011/2012 ensures that there will be no impact on council taxpayers from revisions to accounting standards and that the amount of MRP to be made will be set to ensure that the finance charge and MRP for finance leases and on-balance sheet PFI schemes is equal to the rental or service charge payable in the income and expenditure account for the year, which writes down the balance sheet liability of those assets i.e. the annual MRP charge will be an amount equal to the amount that has been taken to the balance sheet to reduce the liability for that asset.

6.11 In summary, it is recommended that the Council approves the following Annual Minimum Revenue Provision Statement 2011/2012:

a) For all government supported borrowing the Council will adopt Option 1 as set out in the government guidance which is a continuation of the basis upon which the Council currently calculates MRP.

b) For all unsupported borrowing the Council will adopt Option 3 and make MRP repayments using the equal instalment method with the estimated useful life of an asset being assessed by the Executive Director of Commercial and Corporate Services in consultation with appropriate officers.

c) For MRP payments in relation to finance leases and PFI contracts previously held off-balance sheet but now included on-balance sheet to comply with IFRS requirements, the amount of MRP to be made will be set to ensure that the finance charge and MRP for finance leases and on-balance sheet PFI schemes is equal to the rental or service charge payable in the income and expenditure account for the year, which writes down the balance sheet liability of those assets.

d) The Council will make additional voluntary MRP payments to that indicated by the adoption of Option 3, with reference to the Council's framework detailed in 6.7 above where this is considered to be both prudent and affordable. This requirement may be relaxed by the Executive Director of Commercial and Corporate Services where appropriate, in particular for any unsupported borrowing taken out on behalf of trading services, which are subject to market pressures.

Appendix 5

Treasury Management Policy Statement

In line with CIPFA recommendations, on the 3rd March 2010 the Council adopted the following Treasury Management Policy Statement, which defines the policies and objectives of its treasury management activities:

- The Council defines its treasury management activities as: The management of the Council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".

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

- The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

The Council needs to re-affirm its commitment to the above Treasury Management Policy Statement each year.

Treasury Management Strategy Statement for 2011/2012

1. Introduction

1.1 The Local Government Act 2003 and subsequent guidance requires the Council to set out its Treasury Management Strategy for Borrowing and to prepare an Annual Investment Strategy. This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The suggested strategy for 2011/2012 is set out below and is based upon the Executive Director of Commercial and Corporate Services views on interest rates, supplemented with leading market forecasts and other financial data available and advice provided by the Council's treasury adviser, Sector Treasury Services.

1.2 The treasury management strategy covers:

A. Borrowing Policy and Strategy

- treasury limits for 2011/2012 to 2013/2014
- the past and current treasury management position
- the borrowing requirement 2011/2012
- prudential and treasury management Indicators for 2011/12 to 2013/14
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling

B. Annual Investment Policy and Strategy

- Investment policy and objectives
- the investment strategy
- investment types
- investments defined as capital expenditure
- investment limits
- provision for credit related losses
- creditworthiness policy
- monitoring of credit ratings
- past performance and current position
- outlook and proposed investment strategy
- external fund managers
- policy on use of external service providers

2. Borrowing Policy and Strategy

2.1 Treasury Limits for 2011/12 to 2013/14

It is a statutory duty under Section 3 of the Local Government Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and Wales the Authorised Limit represents the legislative limit specified in the Act.

The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is ‘acceptable’.

Whilst termed an “Affordable Borrowing Limit”, the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is set, on a rolling basis, for the forthcoming financial year and two successive financial years and details can be found in Appendix 3 of this report. The Council is asked to approve these limits and to delegate authority to the Executive Director of Commercial and Corporate Services, within the total limit for any individual year, to action movement between the separately agreed limits for borrowing and other long term liabilities where this would be appropriate. Any such changes made will be reported to the Cabinet and the Council at their next meetings following the change.

Also, the Council is asked to approve the Operational Boundary Limits which are included in the Prudential Indicators (Appendix 3). This 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 and the Council is also asked to delegate authority to the Executive Director of Commercial and Corporate Services, within the total operational boundary for any individual year, to action movement between the separately agreed figures for borrowing and other long-term liabilities, in a similar fashion to the authorised limit.

2.2 The Past and Current Treasury Management Position

2.2.1 Interest Rates 2010/2011

Interest rates were fairly static with only small variations during the current financial year, until the government, on 20th October 2010, following the Chancellor’s announcement of the Spending Review, instructed the PWLB to increase the average interest rate on all new loans by an average of 1.00% above the Government’s cost of borrowing. This unexpected change at the time saw an overall increase in all PWLB rates going forward of 0.87% making borrowing from this source both less affordable and less attractive. The table below shows that the largest movement in rates was short term borrowing up to one year of 0.82% and by approximately 0.5% on all other maturity periods. Rates increased because of the government’s actions but there has been a slow fall in interest rates since. This trend is starting to reverse but no significant movements are anticipated for the next financial year. This position will be carefully monitored however.

Loan Type	**31st March 2010 %**	**31st December 2010 %**	**Difference %**
7 Day Notice	0.30	0.40	0.10
1 Month	0.42	0.45	0.03
PWLB – 1 Year	0.83	1.65	0.82
5 Year	2.89	3.33	0.44
10 Years	4.19	4.58	0.39
25 Years	4.67	5.23	0.56
50 Years	4.70	5.16	0.46

The Bank of England Base Rate has remained at 0.50% since 5th March 2009 with little sign that it will be raised in the short term.

2.2.2 **Long Term Borrowing 2010/2011**

The Treasury Management Policy and Strategy Statement for 2010/2011 included a benchmark rate of 4.5% for all long-term borrowing.

The Council's strategy for 2010/2011 is to adopt a pragmatic approach and to respond to any changing circumstances to seek to secure benefit for the Council. In response to the Government's increase in PWLB rates across all PWLB loan periods, the Council's benchmark rate for long-term borrowing was increased to 5.5% for the remainder of 2010/2011.

So far in 2010/2011 £30.50 million of long term borrowing has been undertaken at an average rate of 3.31% (£26.5m in respect of debt rescheduling carried out in earlier years, £3.5m for approved prudential borrowing and £0.5m in respect of a specific loan taken out on behalf of Beamish Museum), details of the new loans are shown below. It is pleasing to report that the replacement borrowing was made before the government unexpectedly and immediately increased borrowing rates by on average 1% across all loan duration periods on 20th October 2010, the date of the Spending Review.

Long Term PWLB Borrowing 2010/2011						
Date	**Amount £m**	**Period (Years)**	**Rate %**	**Benchmark Rate %**	**Margin %**	**Loan Type**
11/05/10	0.50	15	3.65	4.50	0.85	EIP*
25/05/10	10.00	4	1.99	4.50	2.51	Maturity
25/05/10	5.00	50	4.29	4.50	0.21	Maturity
27/07/10	5.00	11	3.75	4.50	1.25	Maturity
27/07/10	5.00	12	3.87	4.50	1.13	Maturity
01/09/10	5.00	50	3.96	4.50	0.54	Maturity
	30.50		**3.31**			
* This loan was taken on behalf of Beamish Museum and is an Equal Instalment of Principal (EIP) loan						

The Council also has nine market, Lender's Option / Borrower's Option (LOBO's), loans totalling £39.5 million. The lender has the option to alter the rate on these loans at set intervals and the Council can either accept the new rate or repay the loan without penalty. If interest rates begin to rise the council will need to consider the potential to have to replace these loans. The following table shows the LOBO's that were subject to a potential rollover in this financial year but have not been replaced as the option was not exercised.

Roll Over Dates	Lender	Amount £m	Rate %	Roll Over Periods
23/04/2010 and 23/10/2010	Barclays	5.0	4.50	Every 6 months (Variable Rate)
14/08/2010	Barclays	5.0	4.45	Every 3 years (Fixed Rate)
Total		**10.0**		

2.2.3 **Current Portfolio Position**

The Council's treasury portfolio position at 31st December 2010 comprised:

		Principal (£m)	Total (£m)	Average Rate (%)
Borrowing				
Fixed Rate Funding	PWLB	138.0		
	Market (LOBO's)	34.5		
	Other	0.4	172.9	3.86
Variable Rate Funding	PWLB	0.0		
	Market (LOBO's)	5.0		
	Temporary/ Other	31.1	36.1	0.92
Total Borrowing			**209.0**	**3.35**
Total Investments	In House		**214.1**	**1.49**
Net Position			**(5.1)**	

The Council currently has a difference between gross debt and net debt of £5.1 million, however this position is expected to change over the next few years as the Council has to manage its finances with significantly less government grant in both capital and revenue funding which could impact in the form of increased borrowing and possible temporary reductions to reserves, with the result that total borrowing could then exceed investments.

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

Benefits of having a high level of investments are;

- liquidity risk – having a large amount of investments means that the Council is at less of a risk should money markets become restricted or borrowing less generally available, this mitigates against liquidity risk;

- interest is received on investments which helps the Council to address its Strategic Priorities;
- the Council has greater freedom in the timing of its borrowing as it can afford to wait until the timing is right rather than be subject to the need to borrow at a time when interest rates are not advantageous.

Risks associated with holding a high level of investments are;

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

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

2.3 **Borrowing Requirement 2011/2012**

The Council's borrowing requirement is as follows**:**

		2011/12 £m	**2012/13 £m**	**2013/14 £m**
1.	Capital Borrowing (potential)	47.7	15.0	15.0
2.	Replacement borrowing (PWLB)	0.0	5.0	5.0
3.	Replacement borrowing (Market)	0.0	0.0	0.0
4.	Market LOBO replacement (potential)	19.5	20.0	10.0
TOTAL – KNOWN (2+3)		**0.0**	**5.0**	**5.0**
TOTAL – POTENTIAL (1+4)		**67.2**	**35.0**	**25.0**

2.4 **Prudential and Treasury Management Indicators for 2011/12 – 2013/14**

Prudential and Treasury Indicators (as set out in Appendix 3) are a requirement of the CIPFA Prudential Code and are relevant for the purposes of setting an integrated treasury management strategy and to ensure that treasury management decisions are taken in accordance with good professional practice.

The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The original 2001 Code was adopted on 20th November 2002 and the revised 2009 Code was adopted by the full Council on 3rd March 2010. The Council also re-affirms its full adherence to the code annually (as set out in Appendix 5).

2.5 **Prospects for Interest Rates**

The Council's treasury advisors are Sector Treasury Services and part of their service is to assist the Council to formulate a view on interest rates. A number of current City forecasts for short term (Bank Rate) and longer fixed interest rates are set out in Annex A. The following gives the Sector Treasury Services Bank Rate forecast for the next 4 financial year ends (March).

- 2010/2011 0.50%
- 2011/2012 1.00%
- 2012/2013 2.25%
- 2013/2014 3.25%

There is a downside risk to these forecasts especially if recovery from the recession proves to be weaker and slower than currently expected and a short term upside risk should inflation pressures increase. A detailed view of the current economic background is contained within Annex B to this report.

2.6 Borrowing Strategy

2.6.1 Borrowing rates

The Sector forecast in respect of interest rates for loans charged by the PWLB is as follows: -

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Mar-13	Mar-14
Bank rate	0.50%	0.50%	0.50%	0.75%	1.00%	2.25%	3.25%
5yr PWLB rate	3.30%	3.30%	3.40%	3.50%	3.60%	4.30%	5.00%
10yr PWLB rate	4.40%	4.40%	4.40%	4.50%	4.70%	5.10%	5.40%
25yr PWLB rate	5.20%	5.20%	5.20%	5.30%	5.30%	5.50%	5.70%
50yr PWLB rate	5.20%	5.20%	5.20%	5.30%	5.30%	5.50%	5.70%

A more detailed forecast from Sector is included in Annex A.

The main sensitivities of the forecast are likely to be;

- if it were felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate borrowing will be undertaken whilst interest rates are still relatively cheap.

- if it were felt that there was a significant risk of a sharp fall in long and short term rates, e.g. due to a marked increase of risks around a relapse into recession or, a risk of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

The Council officers, in conjunction with the Council's treasury advisers, will monitor both the prevailing interest rates and the market forecasts.

With long-term interest rate forecasts set to remain around their current levels the Executive Director of Commercial and Corporate Services, taking into account the advice of the Council's treasury adviser considers a benchmark financing rate of 5.50% for any further long-term borrowing for 2010/2011 to be appropriate.

Consideration will be given to various options, including utilising some investment balances to fund the borrowing requirement in 2011/2012. The need to adapt to changing circumstances and revisions to profiling of capital expenditure is required, and flexibility needs to be retained to adapt to any changes that may occur.

The Executive Director of Commercial and Corporate Services, taking advice from the Council's treasury advisers will continue to monitor rates closely, and whilst implementing the borrowing strategy, will adopt a pragmatic approach in identifying the low points in the interest rate cycle at which to borrow.

2.7 Policy on borrowing in advance of need

The Council will not borrow more than or in advance of its needs purely to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

In determining whether borrowing will be undertaken in advance of need the Council will: -

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need;
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been fully considered;
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;
- consider the merits of alternative forms of funding;
- consider alternative interest forecasts available and the most appropriate periods and repayment profiles to use;
- consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

2.8 Debt Rescheduling

The reasons for any rescheduling of debt will include:

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

In previous years, debt rescheduling has achieved significant savings in interest charges and discounts and these interest savings have been secured for many years to come. For example, since November 2008 the Council has rescheduled debt worth £59.5 million with an ongoing reduction in interest costs of just under £1.0 million per annum. The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt, which has now been compounded since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has meant that PWLB debt restructuring is much less attractive than it was before both of these measures were introduced. Consideration will also be given to other options where interest savings may be achievable by using LOBO (Lenders Option Borrowers Option) loans, and / or other market loans, in rescheduling exercises rather than solely using PWLB borrowing as the source of replacement financing but this would only be the case where this would represent best value to the Council.

The latest interest rate projections for 2011/2012 show short term borrowing rates will be considerably cheaper than longer term rates and as such there may be potential for some opportunities to generate savings by switching from long term debt to short-term debt. However, these savings will need to be considered in the light of the size of premiums incurred, their short term nature, and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio.

The Council is keeping a watching brief on market conditions in order to secure further debt rescheduling when, and if, appropriate opportunities arise. 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 prudent policy will be continued.

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

3. Annual Investment Policy and Strategy

3.1 Investment Policy and Objectives

When considering its investment policy and objectives, the Council has taken regard to the Department of Communities and Local Government's (DCLG) Guidance on Local Government Investments ("the Guidance") and the 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

The Council's investment objectives are: -

(a) the security of capital, and
(b) the liquidity of its investments.

The Council also aims to achieve the optimum return on its investments but commensurate with proper levels of security and liquidity. The risk appetite of the Council is regarded as low in order to give priority to security of its investments.

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

3.2 **Investment Strategy**

This Strategy sets out:

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

3.3 **Investment Types**

The Council is allowed to invest in two types of investment, namely Specified Investments and Non-specified Investments.

Specified Investments are those investments that are for a period of less than one year, are not classed as capital expenditure, and are placed with high credit rated counterparties.

Non-specified Investments are any investments which are not classified as specified investments. As the Council only uses high credit rated counterparties this means in effect that any investments placed with those counterparties for a period of one year or more will be classed as Non-specified Investments. The Council will not invest in any type of investment that will be classed as capital expenditure (see 3.4 below).

The type of investments to be used by the in-house team will be limited to term deposits, interest bearing accounts, and Money Market Funds and will follow the criteria as set out in Annex C.

3.4 **Investments Defined as Capital Expenditure**

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’.

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

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

3.5 Investment Limits

One of the recommendations of the Code is that local authorities should set limits for the amounts of investments that can be placed with institutions by country, sector and group. These limits are applied in the Council's Counterparty criteria set out in Annex C.

The minimum amount of overall investments that the Council will hold in short-term investments (less than one year) is £50 million. As the Council has decided to restrict most of its investments to term deposits, it will maintain liquidity by having a minimum of 30% of these short-term investments maturing within 6 months.

A maximum limit of £100 million is to be set for in-house non-specified investments over 364 days up to a maximum period of 2 years. This amount has been calculated by reference to the Council's cash flows, including the potential use of earmarked reserves. The Executive Director of Commercial and Corporate Services will monitor long-term investment rates and identify any investment opportunities if market conditions change.

3.6 Provisions for Credit Related Losses

If any of the Council's investments appear at risk of loss due to default, (i.e. a credit-related loss, and not one resulting from a fall in price due to movements in interest rates), then the Council will make revenue provision of an appropriate amount in accordance with proper accounting practice or any prevailing government regulations, if applicable. This position has not occurred and the Council mitigates this risk with its prudent investment policy.

3.7 Creditworthiness policy

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

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

3.8 **Monitoring of Credit Ratings**

- All credit ratings are monitored on a daily basis. The Council has access to all three credit ratings agencies and is alerted to changes through its use of the Sector Treasury Services credit worthiness service.

- If a counterparty's rating is downgraded with the result that it no longer meets the Council's minimum criteria, the Council will cease to place funds with that counterparty. The Council will also immediately inform its external fund manager(s), if used, to cease placing funds with that counterparty.

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

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

3.9 **Past Performance and Current Position**

During 2010/2011 the Council did not employ any external fund managers, all funds being managed by the in-house team. The performance of the fund by the in-house team is shown below and compares this with the relevant benchmarks and performance from the previous year:

	2009/10 Return %	2009/10 Benchmark %	2010/11 Return % Year to date	2010/11 Benchmark % Year to date
Council	1.91	0.36	1.49	0.34

During 2010/2011 the Council will continue to review the optimum arrangements for the investment of its funds whilst fully observing the investment strategy in place.

3.10 **Outlook and Proposed Investment Strategy**

Based on its cash flow forecasts, the Council anticipates its fund balances in 2011/2012 are likely to range between £150 million and £300 million. This represents a cautious approach and provides for funding being received in excess of the level budgeted for, and also for unexpected and unplanned levels of capital underspending in the year or reprofiling of spend into future years. In 2011/2012, with short-term interest rates forecast to be materially below long-term rates, it is possible that some investment balances may be used to fund some long-term borrowing or used for debt rescheduling. Such funding is wholly dependent upon market conditions and will be assessed and reported to Cabinet if and when the appropriate conditions arise.

The Council is not committed to any investments, which are due to commence in 2011/2012, (i.e. it has not agreed any forward deals).

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 reprofiling of capital expenditure from, and to, other financial years will also affect cash flow, (no reprofiling 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).

The Executive Director of Commercial and Corporate Services, in conjunction with the Council's treasury adviser Sector Treasury Services, and taking into account the minimum amount to be maintained in short-term investments, will continue to monitor investment rates closely and to identify any appropriate investment opportunities that may arise.

It is proposed that delegated authority continues to be given to the Executive Director of Commercial and Corporate Services, in consultation with the Cabinet Portfolio holder for Resources, to vary the Lending List Criteria and Lending List itself should circumstances dictate, on the basis that changes be reported to Cabinet retrospectively, in accordance with normal Treasury Management reporting procedures.

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

3.11 **External fund managers**

At present the Council does not employ any external fund managers.

Should the Council appoint any external fund managers in the future, they will have to agree to strict investment limits and investment criteria. 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 D);
- they will be allowed to invest in term deposits, Certificates of Deposit (CD's) and government gilt securities;

- An investment limit of £3 million per institution (per manager);
- A maximum limit of 50% fund exposure to government gilts;
- A maximum proportion of the fund invested in instruments carrying rates of interest for periods longer than 364 days shall not exceed 50%. Again, it is proposed to only recommend the use of fixed term deposits up to a maximum of 2 years.

3.12 **Policy on the use of external service providers**

The Council uses Sector as its external treasury management advisers. The Council recognises that responsibility for treasury management decisions remains with the Council at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subject to regular review.

4. Scheme of delegation

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

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

Area of Responsibility	**Council/ Committee/ Officer**	**Frequency**
Treasury Management Policy Statement (revised)	Full Council	Adoption of the new code for 2010/2011 and then as required
Treasury Management Strategy / Annual Investment Strategy	Full Council	Annually before the start of the year
Treasury Management Strategy / Annual Investment Strategy – mid year report	Full Council	Mid year
Treasury Management Strategy / Annual Investment Strategy –updates or revisions at other times	Full Council	As appropriate

Area of Responsibility	**Council/ Committee/ Officer**	**Frequency**
Annual Treasury Management Outturn Report	Full Council	Annually by 30/9 after the end of the financial year
Treasury Management Monitoring Reports	Executive Director of Commercial and Corporate Services	Monthly
Treasury Management Practices	Executive Director of Commercial and Corporate Services	Annually
Scrutiny of Treasury Management Strategy	Cabinet / Audit and Governance Committee	Annually before Full Council
Scrutiny of Treasury Management Performance	Cabinet / Audit and Governance Committee	Quarterly

5. The Treasury Management Role of the Section 151 Officer

5.1 The Executive Director of Corporate Services is the Council's Section 151 Officer and has specific delegated responsibility in the Council's Constitution to manage the borrowing, financing, and investment requirements of the Council in accordance with the Treasury Management Policy agreed by the Council. This includes;

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers.

5.2 Balanced Budget Requirement

It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from: -

- increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
- any increases in running costs from new capital projects,

are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

Increased debt charges that are forecast to arise from the Council's Capital Programme meet the above balanced budget requirement.

Appendix 6

ANNEX A

Interest Rate Forecasts
The data below shows a variety of forecasts published by a number of institutions. The first three are individual forecasts from Sector Treasury Services, Capital Economics (an independent forecasting consultancy) and UBS (which represents summarised figures drawn from the population of all major City banks and academic institutions).

The forecast within this strategy statement has been drawn from these diverse sources and officers' own views.

1. Individual Forecasts

Sector:
Interest rate forecast – 6.1.11

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14
Bank rate	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%	2.25%	2.75%	3.00%	3.25%	3.25%
3 month LIBID	0.60%	0.70%	0.80%	1.00%	1.25%	1.50%	1.75%	2.00%	2.50%	3.00%	3.25%	3.50%	3.50%
6 month LIBID	0.90%	1.00%	1.10%	1.20%	1.50%	1.80%	2.10%	2.40%	2.80%	3.20%	3.50%	3.80%	4.00%
12 month LIBID	1.40%	1.50%	1.60%	1.80%	2.10%	2.40%	2.70%	3.00%	3.20%	3.40%	3.65%	4.00%	4.20%
5yr PWLB rate	3.30%	3.30%	3.40%	3.50%	3.60%	3.80%	3.90%	4.10%	4.30%	4.60%	4.80%	4.90%	5.00%
10yr PWLB rate	4.40%	4.40%	4.40%	4.50%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.30%	5.40%	5.40%
25yr PWLB rate	5.20%	5.20%	5.20%	5.30%	5.30%	5.40%	5.40%	5.40%	5.50%	5.50%	5.60%	5.70%	5.70%
50yr PWLB rate	5.20%	5.20%	5.20%	5.30%	5.30%	5.40%	5.40%	5.40%	5.50%	5.50%	5.60%	5.70%	5.70%

Capital Economics:
Interest rate forecast – 12.1.11

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.50%	2.00%
5yr PWLB rate	3.20%	3.20%	3.00%	2.75%	2.75%	2.90%	3.00%	3.20%	3.40%	3.60%	3.90%	4.20%
10yr PWLB rate	4.75%	4.75%	4.25%	3.75%	3.75%	3.75%	3.75%	3.75%	3.90%	4.00%	4.30%	4.60%
25yr PWLB rate	5.25%	5.25%	4.85%	4.65%	4.65%	4.65%	4.65%	4.65%	4.75%	4.85%	5.10%	5.30%
50yr PWLB rate	5.30%	5.30%	5.20%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.10%	5.20%	5.30%

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ANNEX A

UBS:
Interest rate forecast (for quarter ends) – 6.1.11

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
Bank rate	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%	2.00%
10yr PWLB rate	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%
25yr PWLB rate	5.25%	5.30%	5.35%	5.40%	5.45%	5.50%	5.55%	5.60%
50yr PWLB rate	5.35%	5.40%	5.45%	5.50%	5.55%	5.60%	5.65%	5.70%

2. Survey of Economic Forecasts

HM Treasury January 2011
The current Q4 2010 and 2011 forecasts are based on the January 2011 report. Forecasts for 2010 – 2014 are based on 32 forecasts in the last quarterly forecast – in November 2010.

BANK RATE FORECASTS		quarter ended		annual average Bank Rate			
	actual	Q4 2011		ave. 2011	ave. 2012	ave. 2013	ave. 2014
Median	0.50%	1.00%		0.90%	1.60%	2.40%	3.00%
Highest	0.50%	1.60%		2.10%	3.10%	3.60%	4.50%
Lowest	0.50%	0.50%		0.50%	0.50%	0.60%	1.20%

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ANNEX B

Economic Background

1.1 Global economy

The economic downturn that began following the global credit crunch of August 2007 has continued into 2011. The sovereign debt crisis peaked in May 2010 prompted by major concerns over the size of the Greek government's total debt and annual deficit. Any default or write down of Greek debt would have a substantial impact on other countries, in particular, Portugal, Spain and Ireland. This crisis culminated in the EU and IMF putting together a €750bn support package in mid May. A second crisis, this time over Ireland in November 2010, culminated in Ireland also having to take EU support. There is a concern that Portugal will also shortly need to take EU support. That, in turn, would then cause further major concerns as to whether the current size of the support package facility put together by the EU and IMF would be big enough to cope with any crisis involving another major economy.

The unexpectedly high rate of growth in quarters 2 and 3 of 2010 in the UK and the Euro zone in Q2 were driven by strong growth in the construction sector catching up from inclement weather earlier in the year and by other short term factors. General expectations are for low (but not negative) growth in 2011 in the western economies.

1.2 UK economy

Following the general election in May 2010, the coalition government has put in place austerity measures to carry out a 'correction' of the public sector deficit over the next five years. The result of fiscal contraction will be major job losses during this period, in particular, in public sector services. This will have a knock-on effect on consumer and business confidence and appears to have also hit the housing market as house prices started on a negative trend during the summer and autumn of 2010. Mortgage approvals are also at very weak levels and are declining, all of which indicates that the housing market is likely to be very weak in 2011.

Economic Growth – GDP growth is likely to have peaked in the current period of recovery at 1.2% in quarter 2 of 2010. Growth in quarter 3 at +0.7% was also unexpectedly high. However, the outlook is for low growth in 2011/2012 although the Bank of England and the Office for Budget Responsibility are forecasting near trend growth (2.5%) i.e. above what most forecasters are currently expecting.

Unemployment – the trend of falling unemployment (on the benefit claimant count) has been replaced since July 2010 with small increases which are likely to be the start of a new trend for some years ahead of rising unemployment.

Inflation and Bank Rate – CPI has remained high during 2010. It peaked at 3.7% in April gradually declined to 3.1% in September but has now returned to the level of 3.7% in December (RPI 4.7%). Although inflation has remained above the MPC's 2% target, the MPC is confident that inflation will fall back under the target over the next two years.

ANNEX B

The Bank of England finished its programme of quantitative easing (QE) with a total of £200bn in November 2009. However, expectations that there could be a second round of quantitative easing in early 2011, to help support economic growth, have evaporated after the surprises of the Q3 GDP figure of +0.7% and the outcome of the November Inflation Report revising the forecast for short-term inflation sharply upwards.

Sector's view is that there is unlikely to be any increase in the Bank Base Rate until the end of 2011.

AAA rating – prior to the general election, credit rating agencies had issued repeated warnings that unless there was a major fiscal contraction, then the AAA sovereign rating was at significant risk of being downgraded. Sterling was also under major pressure during the first half of the year. However, after the Chancellor's Emergency Budget on 22nd June 2010, Sterling strengthened against the US dollar and confidence has returned that the UK will retain its AAA rating. In addition, international investors now view UK government gilts as being a safe haven from EU government debt. The consequent increase in demand for gilts helped to add downward pressure on gilt yields and PWLB rates.

1.3 Economic Forecast

It is currently difficult to have confidence as to exactly how strong the UK economic recovery is likely to be, and there are a range of views in the market. Sector Treasury Services has adopted a moderate view. There are huge uncertainties in all forecasts due to the major difficulties of forecasting the following areas:

- the speed of economic recovery in our major trading partners - the US and EU
- the danger of a currency war and a resort to protectionism and tariff barriers if China does not address the issue of its huge trade surplus due to its undervalued currency
- the degree to which government austerity programmes will dampen economic growth and undermine consumer confidence
- changes in the consumer savings ratio
- the speed of rebalancing of the UK economy towards exporting and substituting imports
- the potential for more quantitative easing, and the timing of this in both the UK and US, and its subsequent reversal
- the speed of recovery of banks' profitability and balance sheet imbalances and the consequent implications for the availability of credit to borrowers
- the potential for a major EU sovereign debt crisis which could have a significant impact on financial markets and the global and UK economy

The overall balance of risks is weighted to the downside and there is some risk of a double dip recession, creating a downward spiral of falling demand, falling jobs and falling prices, although this is currently viewed as being a small risk. Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries.

Lending List Criteria **ANNEXC**

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	Maximum Deposit £m	Maximum Duration
AAA	F1+	A1+	Aaa	P-1	50	2 Years
AA+	F1+	A1+	Aa1	P-1	50	2 Years
AA	F1+	A1+	Aa2	P-1	40	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
Money Market Funds Maximum amount to be invested in Money Market Funds is £50 million with a maximum of £30 million in any one fund.					50	2 Years

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.

Where any banks / building societies are part of the UK Government's Credit Guarantee scheme (marked with * in the Approved Lending List), these counterparties will have an AA rating applied to them thus giving them a credit limit of £40 million for a maximum period of 364 days

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:

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ANNEX C

Country Limit
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 total limit of £40 million which can be invested in other countries provided they meet the above criteria. A separate limit of £300 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	300
Non UK	40

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	300
Local Government	300
UK Banks	300
UK Building Societies	150
Foreign Banks	40

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.

Proposed group limits are set out in Annex D

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Approved Lending List **ANNEX D**

	Fitch				Moody's			Standard & Poor's			
	L Term	S Term	Individual	Support	L Term	S Term	Fin Strength	L Term	S Term	Limit £m	Max Deposit Period
UK	AAA	F1+			Aaa			AAA		300	364 days
Lloyds Banking Group (see Note 1)										**Group Limit 50**	
Lloyds Banking Group plc	AA-	F1+	C	1	Aa3	-	-	A	A-1	50	364 days
Lloyds TSB Bank Plc	AA-	F1+	C	1	Aa3	P-1	C-	A+	A-1	50	364 days
Bank of Scotland Plc	AA-	F1+	C	1	Aa3	P-1	D+	A+	A-1	50	364 days
Royal Bank of Scotland Group (See Note 1)										**Group Limit 50**	
Royal Bank of Scotland Group plc	AA-	F1+	C/D	1	A1	P-1	-	A	A-1	50	364 days
The Royal Bank of Scotland Plc	AA-	F1+	C/D	1	Aa3	P-1	C-	A+	A-1	50	364 days
National Westminster Bank Plc	AA-	F1+	-	1	Aa3	P-1	C-	A+	A-1	50	364 days
Ulster Bank Ltd	A+	F1+	E	1	A2	P-1	D-	A	A-1	50	364 days
Santander Group *										**Group Limit 40**	
Santander UK plc	AA-	F1+	B	1	Aa3	P-1	C-	AA	A-1+	40	364 days
Cater Allen	AA-	F1+	B	1	Aa3	P-1	C-	AA	A-1+	40	364 days
Barclays Bank plc *	AA-	F1+	B	1	Aa3	P-1	C	AA-	A-1+	40	364 days
HSBC Bank plc *	AA	F1+	B	1	Aa2	P-1	C+	AA	A-1+	40	364 days

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ANNEX D

	Fitch			**Moody's**				**Standard & Poor's**			
	L Term	S Term	Individual	Support	L Term	S Term	Fin Strength	L Term	S Term	Limit £m	Max Deposit Period
Nationwide BS *	AA-	F1+	B	1	Aa3	P-1	C-	A+	A-1	40	364 days
Standard Chartered Bank *	AA-	F1+	B	1	A2	P-1	C+	A+	A-1	40	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 ***	BBB +	F2	C	2	-	-	-	A-	A-2	0	
Top 10 Building Societies (by asset value)											
Nationwide BS (see above)											
Yorkshire BS	A-	F2	B/C	5	Baa1	P-2	D+	A-	A-2	0	
Coventry BS	A	F1	B	5	A3	P-2	C-	-	-	5	6 Months
Skipton BS	A-	F2	B/C	5	Baa1	P-2	D+	-	-	0	
Leeds BS	A	F1	B/C	5	A2	P-1	C+	-	-	10	364 Days
West Bromwich BS ***	BBB-	F3	C/D	5	Baa3	P-3	E+	-	-	0	
Principality BS ***	BBB +	F2	C	5	Baa2	P-2	D-	-	-	0	
Newcastle BS ***	BBB-	F3	C/D	5	Baa2	P-2	D-	-	-	0	
Norwich and Peterborough BS ***	BBB +	F2	C	5	Baa2	P-2	D	-	-	0	
Nottingham BS	-	-	-	-	A3	P-2	C-	-	-	5	6 Months
Foreign Banks have a combined total limit of £40m											
Australia	AA+	-	-	-	Aaa	-	-	AAA		40	364 Days
National Australia Bank	AA	F1+	B	1	Aa1	P-1	B	AA	A-1+	40	364 Days
Australia and New Zealand Banking Group Ltd	AA-	F1+	B	1	Aa1	P-1	B	AA	A-1+	20	364 Days

ANNEX D											
	Fitch				**Moody's**			**Standard & Poor's**			
	L Term	S Term	Individual	Support	L Term	S Term	Fin Strength	L Term	S Term	Limit £m	Max Deposit Period
Commonwealth Bank of Australia	AA	F1+	A/B	1	Aa1	P-1	B	AA	A-1+	40	364 Days
Westpac Banking Corporation	AA	F1+	A/B	1	Aa1	P-1	B	AA	A-1+	40	364 Days
Canada	**AAA**				**Aaa**			**AAA**		40	364 Days
Bank of Nova Scotia	AA-	F1+	B	1	Aa1	P-1	B	AA-	A-1+	20	364 Days
Royal Bank of Canada	AA	F1+	A/B	1	Aa1	P-1	B+	AA-	A-1+	20	364 Days
Toronto Dominion Bank	AA-	F1+	B	1	Aaa	P-1	B+	AA-	A-1+	20	364 Days
Money Market Funds										50	2 Years
Prime Rate Stirling Liquidity	AAA MMF							AAAm		30	2 Years
Insight Liquidity Fund					AAA MR1			AAAm		30	2 Years
Ignis Sterling Liquidity	AAA MMF							AAAm		30	2 Years

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 revised credit limit of £50 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 an AA rating applied to them thus giving them a revised credit limit of £40 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.