

STROUD DISTRICT COUNCIL

AGENDA
ITEM NO

COUNCIL

24 February 2011

8(a)

Report Title	TREASURY MANAGEMENT STRATEGY, ANNUAL INVESTMENT STRATEGY AND MINIMUM REVENUE PROVISION POLICY STATEMENT 2011/12
Purpose of Report	<p>This report outlines the Council's prudential indicators for 2011/12 – 2013/14 and sets out the treasury strategy for this period. It fulfils three key reports required by the Local Government Act 2003:</p> <ul style="list-style-type: none"> • reporting prudential indicators required by the CIPFA Prudential Code for Capital Finance in Local Authorities; • a treasury management strategy in accordance with the CIPFA Code of Practice on Treasury Management; • an investment strategy in accordance with the DCLG investment guidance. <p>It also fulfils the statutory duty to approve a minimum revenue policy statement for 2011/12.</p>
Decision(s)	<p>The Audit Committee RECOMMENDS to Council:</p> <ol style="list-style-type: none"> 1. to adopt the prudential indicators and limits for 2011/12 to 2013/14; 2. to approve the treasury management strategy 2011/12, and the treasury prudential indicators; 3. to approve the investment strategy 2011/12, and the detailed criteria for specified and non-specified investments; 4. to approve the Minimum Revenue Policy Statement 2011/12.
Consultation and Feedback	Sector Treasury Services.
Financial Implications & Risk Assessment	<p>There are no financial implications arising from this report.</p> <p>It is important that the Council follows the approved Treasury Management Strategy which is designed to protect the Council's finances by limiting exposure to risk.</p> <p>Sandra Cowley, Head of Finance Tel: 01453 754136 E-mail: sandra.cowley@stroud.gov.uk</p>

Legal Implications	<p>The relevant statutory framework is set out in the report. Otherwise, no specific legal implications arise directly from the report.</p> <p>Peter Cruden, Interim Legal Services Manager Tel: 01453 754369 E-mail: peter.cruden@stroud.gov.uk</p>
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Portfolio Holder	<p>Councillor Nigel Cooper Cabinet Member for Finance Tel: 01452 813870 E-mail: cllr.nigel.cooper@stroud.gov.uk</p>
Options	<p>Full Council is required to adopt the prudential indicators and approve the annual treasury management strategy. These are, to a significant extent, determined by the revenue and capital budget decisions being made by the Council when setting the 2011/12 Council Tax and Housing rent levels.</p>
Performance anagement Follow Up	<p>Half-yearly and annual Treasury Management reports of actual compared with estimated prudential indicators for 2011/12.</p> <p>Any breaches of the Prudential Code will be reported to the Audit Committee. A breach of the Authorised Borrowing Limit would require immediate investigation and reporting to Council.</p>
Background Papers	<p>Treasury Management Policy Statement; Treasury Management Practices, Part 1 Main Principles and Part 2 Schedules as revised and updated by end of February 2011 available on the Members' intranet.</p> <p>Chartered Institute of Public Finance and Accountancy – The Prudential Code for Capital Finance in Local Authorities & Guidance Notes (revised 2009)</p> <p>Reports:</p> <ul style="list-style-type: none"> • Capital Programme and Proposed Schemes, Cabinet 6 January 2011 • General Fund Revenue Estimates – Revised 2010/11 and Original 2011/12, Cabinet 6 January 2011 • HRA Estimates Revised 2010/11 and Original 2011/12, Cabinet 6 January 2011
Appendices	<ul style="list-style-type: none"> A. Treasury Management Policy Statement B. Investments at 31 January 2011 C. Explanation of prudential indicators D. Economic Background

Discussion

1. Under the Local Government Act 2003 (the Act) and supporting regulations the Council is required to “have regard to” the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council’s capital investment plans are affordable, prudent and sustainable.
2. Also, the Council is required to approve an Annual Treasury Management Strategy Statement for borrowing, and an Investment Strategy which sets out the Council’s policies for managing its investments, and for giving priority to security and liquidity of investments. The Department of Communities and Local Government (DCLG) has issued revised investment guidance taking effect from 1 April 2010. There were no significant changes in that guidance over and above the changes required by the revised CIPFA Treasury Management Code of Practice 2009.
3. Also, there is a statutory duty to approve a Minimum Revenue Provision Policy Statement for the year and this is set out in Section L of this report.
4. CIPFA Code of Practice on Treasury Management (revised November 2009) as adopted by this Council on 21 January 2010 requires the Council to maintain a Treasury Management Manual, which is reviewed annually. An updated copy will be available on the Members’ intranet from the end of February 2011. This manual is a record of internal procedures and operational guidance, as such it does not need to be approved by Members. The manual incorporates the following documentation relating to Treasury management:-
 - Treasury Management Policy Statement. This was approved by Members in 2002 and is reviewed annually. See Appendix A.
 - Treasury Management Practices (TMP) – Main Principles. There are 12 practices which set out the manner in which this Council will seek to achieve its treasury management policies and objectives and how it will manage and control those activities. These were adopted in 2002. They are reviewed annually.
 - Treasury Management Practices – Schedules. These schedules set out the details of how the TMPs are put into effect by this Council. This document is revised annually to include the latest detailed procedural documents.
 - Counterparty Lending List and lending criteria. The list used by the Council is provided by Sector Treasury Services, the Council’s treasury advisors. A new list is provided weekly, and there are daily updates by email of any changes to ratings.
5. Other CIPFA requirements are:-
 - a Mid-year Review Report and an Annual Report covering activities during the previous year;
 - delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions. At this Council, delegation is to the Head of Finance, the Council’s Section 151 officer;
 - delegation by the Council of the role of scrutiny of treasury management reports and strategy to a specific named body. For this Council the delegated body is the Audit Committee.

Treasury Management Strategy Statement, Annual Investment Strategy and Minimum Revenue Provision Strategy 2011/12

A. INTRODUCTION

1. The Act and supporting regulations require the Council to 'have regard to' the CIPFA Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.
2. The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act). This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.
3. Strategy for 2011/12 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor, Sector Treasury Services . The strategy covers:
 - limits in force to mitigate the Council's treasury risk;
 - Prudential Indicators;
 - current treasury position;
 - borrowing requirement;
 - prospects for interest rates;
 - borrowing strategy;
 - policy on borrowing in advance of need;
 - investment strategy;
 - creditworthiness policy;
 - policy on use of external service providers;
 - Minimum Revenue Provision (MRP) statement;
 - treasury management scheme of delegation and section 151 role;
 - extraordinary treasury issues.
4. 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 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 projectsare limited to a level which is affordable for the foreseeable future.

B. TREASURY LIMITS FOR 2011/12 TO 2013/14

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

6. 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'.
7. 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 to be set, on a rolling basis, for the forthcoming financial year and two successive financial years. The authorised limit is shown in table 2 below.

C. PRUDENTIAL INDICATORS FOR 2011/12 TO 2013/14

8. Prudential indicators are relevant for the purposes of setting an integrated treasury management strategy. They are set out in Tables 1 to 3 below. An explanation of prudential indicators is shown in Appendix C.
9. The Council is required to indicate if it has adopted the CIPFA code of Practice on Treasury Management. This original 2001 code was adopted on 25 April 2002 and the revised 2009 code was adopted on 21 January 2010 by full Council. The Council's Treasury Management Policy Statement is shown in Appendix A.

Table 1: Prudential Indicators 2011/12 to 2013/14 (see Appendix C)

PRUDENTIAL INDICATOR	2009/10	2010/11	2011/12	2012/13	2013/14
	£'000	£'000	£'000	£'000	£'000
	actual	estimated out-turn	estimate	estimate	estimate
Capital Expenditure					
Non - HRA	£2,634	£9,490	£5,778	£5,809	£6,433
HRA	£4,288	£5,018	£6,300	£6,181	£6,388
TOTAL	£6,922	£14,508	£12,078	£11,990	£12,821
Ratio of financing costs to net revenue stream					
Non - HRA	-2.94%	-1.98%	-1.02%	-1.08%	-2.32%
HRA	-1.17%	-0.67%	-0.42%	-0.45%	-0.77%
Net borrowing requirement					
brought forward 1 April	-	-	-	-	-
carried forward 31 March	-	-	-	-	-
in year borrowing requirement	-	-	-	-	-
In year Capital Financing Requirement					
Non - HRA	£2,250	-	-	-	-
HRA	-	-	-	-	-
TOTAL	£2,250	-	-	-	-
Capital Financing Requirement as at 31 March					
Non - HRA	£7,569	£7,569	£7,569	£7,569	£7,569
HRA	-£6,737	-£6,737	-£6,737	-£6,737	-£6,737
TOTAL	£832	£832	£832	£832	£832
Incremental impact of capital investment decisions	£ p	£ p	£ p	£ p	£ p
Increase in Council Tax (band D) per annum	£0.18	£0.20	-£0.13	-£0.35	£0.00
Increase in average housing rent per week	-£0.20	-£0.01	£0.05	£0.10	£0.17

Table 2: Treasury Management Prudential Indicators (see Appendix C)

PRUDENTIAL INDICATOR	2009/10	2010/11	2011/12	2012/13	2013/14
TREASURY MANAGEMENT	£'000	£'000	£'000	£'000	£'000
	actual				
Authorised Limit for external debt -					
borrowing	£2,000	£6,000	£6,000	£6,000	£6,000
other long term liabilities	-	-	-	-	-
TOTAL	£2,000	£6,000	£6,000	£6,000	£6,000
Operational Boundary for external debt -					
borrowing	£2,000	£4,000	£4,000	£4,000	£4,000
other long term liabilities	-	-	-	-	-
TOTAL	£2,000	£4,000	£4,000	£4,000	£4,000
Upper limit for fixed interest rate exposure					
Net principal re fixed rate borrowing / investments	100%	100%	100%	100%	100%
Upper limit for variable rate exposure					
Net principal re variable rate borrowing / investments	100%	100%	100%	100%	100%
Upper limit for total principal sums invested for over 364 days (per maturity date)	£10,000	£6,000	£6,000	£6,000	£6,000

Table 3: Maturity Structure of new fixed rate borrowing

Maturity structure of new fixed rate borrowing during 2011/12	upper limit	lower limit
under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

D. CURRENT TREASURY POSITION**Table 4: The Council's treasury portfolio position at 31/01/2011**

	Principal		Ave. rate
	£m	£m	%
Fixed rate funding	PWLB	0.8	
	Market	-	0.8
			0.62%
Variable rate funding	PWLB	-	
	Market	-	0
			-
Other long term liabilities		-	
GROSS DEBT		0.8	-
TOTAL INVESTMENTS - see Appendix B		22.7	1.40%
NET DEBT		21.9	1.43%

E. BORROWING REQUIREMENT

Table 5: Borrowing requirement

	2009/10	2010/11	2011/12	2012/13	2013/14
	£'000 actual	£'000 probable	£'000 estimate	£'000 estimate	£'000 estimate
New borrowing	800	-	-	-	-
Alternative financing arrangements	-	-	-	-	-
Replacement borrowing	-	800	800	800	800
TOTAL CFR (borrowing requirement)	800	800	800	800	800

F. PROSPECTS FOR INTEREST RATES

10. Sector Treasury Services are treasury advisers to the Council and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the latest Sector forecast.

Table 6: Sector interest rate forecast as at 11 January 2011

	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%
5yrPW LB rate	3.30%	3.30%	3.40%	3.50%	3.60%	4.30%	5.00%
10yrPW LB rate	4.40%	4.40%	4.40%	4.50%	4.70%	5.10%	5.40%
25yrPW IB rate	5.20%	5.20%	5.20%	5.30%	5.30%	5.50%	5.70%
50yrPW IB rate	5.20%	5.20%	5.20%	5.30%	5.30%	5.50%	5.70%

G. BORROWING STRATEGY

11. Current capital spending plans are forecast to be funded from future capital receipts, revenue contributions, grants, partner contributions and the use of reserves. Therefore it is not proposed to borrow in order to finance the current capital programme.
12. As a result of government funding cutbacks arising from the Comprehensive Spending Review, revenue reserves and balances are likely to diminish over the medium term. Also, there will be a sharp increase in planned spending on the canal, and there will often be a time lag between the Council spending and receiving funding from project partners. These factors mean that there is an increased likelihood of short-term borrowing for cashflow purposes during the medium term.
13. If short-term borrowing becomes necessary the Head of Finance will take advice from Sector as to the most advantageous time and source for such borrowing.

H. POLICY ON BORROWING IN ADVANCE OF NEED

14. The Council will not borrow more than, or in advance of, its needs purely in order 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.

15. 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 considered;
 - evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;
 - consider the merits and demerits of alternative forms of funding;
 - consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use;
 - consider the impact of borrowing in advance of need of 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.

I. INVESTMENT STRATEGY

Investment Policy

16. The Council will have regard to the DCLG's Guidance on Local Government Investments ("the Guidance") issued in March 2004, any revisions to that guidance such as the March 2010 revision, and the 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA Treasury Management Code"). The Council's investment priorities are: -
- security of capital and
 - liquidity of investments.
17. The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of investments.
18. The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.
19. Investment instruments identified for use in the financial year are listed below under the 'Specified' and 'Non-Specified' Investments categories.

Specified Investments

20. All investments will be sterling denominated, with maturities up to a maximum of 1 year (including any forward deal time), subject to Sector's colour coding rating system as set out in creditworthiness policy paragraphs 28 -34.

Table 7: Specified Investments

Type of Investment	Minimum 'High' Credit Criteria	Max. Sum per institution / group
Debt Management Agency Deposit Facility	*	£5m
Term deposits – local authorities	*	£5m
Term deposits – banks and building societies	UK Government Guarantee Scheme ^a	£5m per bank & £8m per group
Term deposits – banks and building societies	Colour coded as per Sector Weekly counterparty listing (AAA countries & UK only)	£5m
UK Government Gilts	*	£5m
Bonds issued by multilateral development banks	*	£5m
Bonds issued by a financial institution which is guaranteed by the UK government	*	£5m
Treasury Bills	*	£5m
Certificates of deposits issued by banks and building societies	Colour coded as per Sector Weekly counterparty listing (AAA countries & UK only)	£5m
Money Market Funds	Fitch AAA V1+ or Moodys Aaa MR1+ or S&P AAAm	£5m in money market funds in total

^a Abbey, Barclays, HBOS, Lloyds TSB, HSBC, Nationwide Building Society, RBS and Standard Chartered.

Non-Specified Investments

21. All investments will be sterling denominated.

Table 8: Non-specified Investments - Maturities in excess of 1 year

Financial instrument / institution	Minimum Credit Criteria	Max. maturity period	Max. Sum**
Term deposits – banks and building societies	Colour coded as per Sector Weekly counterparty listing (AAA countries & UK only)	3 years	£5m
Certificates of deposits issued by banks and building societies	Colour coded as per Sector Weekly counterparty listing (AAA countries & UK only)	3 years	£5m
UK Government Gilts	*	3 years	£5m
Bonds issued by multilateral development banks	*	3 years	£5m
Bonds issued by a financial institution which is guaranteed by the UK government	*	3 years	£5m

* Government institutions have the highest security, although they are not formally rated

** A maximum sum of £5m refers to the combined total of specified and non-specified investments with a particular bank.

Investment Strategy

22. Investments will be made primarily with reference to cash flow requirements and the outlook for short-term interest rates. Investments made during 2010 have been exclusively on call or in the 1 to 3 month range. Investments over one year will be dependent on recommendation by Sector, subject to a maximum of £6m aggregate, and only if liquidity requirements can be met. The maximum investment period permitted under the Council's investment strategy is 3 years.
23. Whilst world financial market uncertainty persists the Council is keeping investments, where possible, short-dated and within the UK. However, with a limited number of suitable creditworthy institutions available to invest in, diversification of investments remains challenging. As a consequence, the limit for specified investments with banking groups benefiting from the UK government support is £8m. Whilst, the limit for any one bank within a group is still £5m.

Table 9: Investments maturing after the end of the current financial year.

<i>Financial Institution</i>	<i>Amount</i>	<i>Maturity</i>	<i>Rate</i>
<i>Barclays Bank</i>	<i>2,000,000</i>	<i>16/06/2011</i>	<i>6.72%</i>

24. Bank Rate has been unchanged at 0.5% since March 2009. Bank Rate is forecast to commence rising in quarter 4 of 2011 and then rise steadily thereafter.
25. For 2011/12 Sector advice is to budget for an investment return of 0.9% on investments placed during 2011/12.
26. For cash flow generated balances, the Council will seek to utilise its call accounts, money market funds, base rate plus accounts and short-dated deposits (overnight to three months) so long as these accounts continue to have relatively high interest rates. This will enable the Council to benefit from the compounding of interest.
27. At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

J. CREDITWORTHINESS POLICY

28. This Council uses the creditworthiness service provided by Sector Treasury Services. This service has been progressively enhanced over the last year and now uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard & Poors, forming the core element. However, it does not rely solely on the current credit ratings of counterparties, but also uses the following as overlays: -
 - credit watches and credit outlooks from credit rating agencies
 - credit default swap (CDS) spreads to give early warning of likely changes in credit ratings
 - sovereign ratings to select counterparties from only the most creditworthy countries
29. This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system, combined with an overlay of CDS spreads. The end product is a series of colour code bands, which indicate the relative creditworthiness of counterparties. These colour codes are also used by

the Council to determine the duration for investments and are therefore referred to as durational bands. The Council is satisfied that this service gives a much better level of security for its investments. It is a service the Council would not be able to replicate using in-house resources.

30. The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions from a colour coded durational band within Sector's weekly list of worldwide potential counterparties. The Council will use counterparties within the following durational bands : -

- Yellow 3 years
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No Colour not to be used

31. This Council follows Sector's advice and does not use CIPFA's suggested approach of using the lowest rating from all three rating agencies to determine creditworthy counterparties. Moodys tend to be more aggressive in giving low ratings than the other two agencies, so this approach would leave the Council with few banks on its approved lending list. Sector creditworthiness service uses a risk weighted scoring system of all three agencies and does not give undue weight to any one agency's ratings.

32. Credit ratings are updated on a weekly list, supplemented by daily emails, which are consulted prior to making an investment decision. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

- a downgrade resulting in the counterparty no longer meeting the Council's minimum criteria will not be used for future investments;
- in addition to the use of credit ratings the Council will be advised of information in movements in CDS, against the iTraxx benchmark, and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list.

33. Sole reliance will not be placed on the use of this external service. This Council will use in addition market data, market information, information on government support for banks and the credit ratings of that government support.

Country limits

34. The Council has determined that it will only use approved counterparties outside of the UK from countries with a **minimum sovereign credit rating of AAA** from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). Investment in any one country outside the UK will be limited to £5m:

Canada	Norway	Singapore	U.S.A.
Denmark	Germany	Sweden	
Finland	Luxembourg	Switzerland	
France	Netherlands	U.K.	

K. USE OF EXTERNAL SERVICE PROVIDERS

35. Sector Treasury Services are the Council's treasury management advisers. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon any external service provider.
36. It also recognises that there is value in employing external providers of treasury management services in order to access specialist skills and resources. The Head of Finance will ensure that an external service provider's performance is monitored and subjected to regular review.

L. MINIMUM REVENUE PROVISION POLICY (MRP) STATEMENT 2011/12

37. The Council assess their MRP for 2011/12 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003. MRP is only chargeable on General Fund outstanding capital liabilities.
38. After taking into account the recognised adjustments for the Housing Amount and Adjustment A, it is anticipated that, as at 31 March 2011, the Council will have a negative capital financing requirement, for MRP purpose.
39. As outlined in the DCLG Guidance, where the capital financing requirement (CFR) is nil or negative on the last day of a financial year, this indicates that the authority's provision for debt is equal to or greater than the debt incurred. There is accordingly no need to make MRP in the following financial year under any of the specified options, or in any other way.
40. The Council's MRP liability for 2010/11 is therefore NIL.
41. It is important to note that, if the Council reaches a point where its CFR (for MRP purposes) becomes positive, an MRP policy statement for making a prudent minimum revenue provision would be needed in accordance with DCLG Guidance.

M. TREASURY MANAGEMENT SCHEME OF DELEGATION AND ROLE OF THE SECTION 151 OFFICER

1. Council

- Approval of annual strategy

2. Audit Committee

- Approval of regular monitoring reports
- Receiving and reviewing reports on treasury management strategy, policy and activity

3. Section 151 Officer / Head of Finance

- Reviewing the treasury management policy, procedures, strategy and making recommendations to the Audit Committee;
- Approving the selection of external service providers and agreeing terms of appointment;
- Submitting regular treasury management strategy reports;
- 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 on internal audit and liaising with external audit.

N. EXTRAORDINARY TREASURY ISSUES

Housing Revenue Account (HRA) Self-Financing

42. Part of the forthcoming Localism Bill is dealing with the issue of HRA self-financing. It is likely that this bill will result in the Council taking on debt of approximately £95m in exchange for release from the current housing subsidy regime. Once the bill is published the Council will need to take specialist advice so as to take advantage of any treasury management opportunities that may arise.
43. Consequently, borrowing and investment limits set in this report may need to be revised later in the year once full details of the new HRA financing are known.

Icelandic bank investments

44. This authority currently has the following investments at risk in Icelandic banks.

Table 10: Investments at risk in Icelandic Banks

Financial Institution	Amount	Maturity	Rate
<i>Glitnir Bank</i>	<i>1,000,000</i>	<i>14/04/2009</i>	<i>6%</i>
<i>Glitnir Bank</i>	<i>2,000,000</i>	<i>02/01/2009</i>	<i>5.61%</i>

45. The Local Government Association is co-ordinating a legal challenge in the Icelandic courts to secure preferred creditor status for the Council's investments. Proceedings are expected to commence in February 2011. In the meantime, the Council was granted, and has applied, a capitalisation directive by the UK government to mitigate any potential losses arising from an adverse court decision.

King & Shaxon

46. The Council has opened a Custodian Account, at no cost, through King & Shaxon, who are partners of Sector Treasury Services. This will enable the Council to invest in UK government treasury bills, UK government gilts and certificates of deposit issued by highly rated banks. These secure types of investment have been unavailable to the Council until now due to lack of access to a Custodian Account. This will help to address the problem of diversification of investments.

Member Training

47. Treasury Management training for members was provided by Sector Treasury Services on 13 April 2010 and 11 October 2010 to enable Audit Committee members to fulfill their role more effectively. These training events were also open to all members to attend. Further training will be scheduled early in the new civic year to benefit any new Audit Committee members.

TREASURY MANAGEMENT POLICY STATEMENT

1. Stroud District Council defines its treasury management activities as: “The management of the organisation’s cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”
2. Stroud District 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.
3. Stroud District Council acknowledges that 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 performance measurement techniques, within the context of effective risk management.

INVESTMENTS AS AT 31 JANUARY 2011

Counterparty	£	%	S / NS	Type	Issue	Maturity
NatWest Treasury Reserve	4,976,794	0.90%	S	Call		
RBS Deposit Account	690,915	0.80%	S	Call		
NatWest/RBS Group Total	5,667,710					
Royal Bank of Scotland	612	0.57%	S	Call		
Prime Rate - now available	4,729,554	0.85%	S	Call		
Money Market Funds Total	4,730,166					
35 Day Notice a/c	1,042,000	0.75%	S	Notice	16/12/2010	15/02/2011
10 Day Notice a/c	2,280,000	0.50%	S	Notice	17/01/2011	08/02/2011
Svenska Total	3,322,000					
Barclays Bank Plc	2,000,000	6.72%	NS	Fixed	16/06/2008	16/06/2011
Barclays Total	2,000,000					
BOS/Lloyds	2,999,685	1.00%	S	Call		
ST02 10/11 Bank of Scotland	2,000,000	1.12%	S	Fixed	14/12/2010	15/03/2011
Lloyds	2,000,000	1.12%	S	Fixed	05/01/2011	21/03/2011
Lloyds/BOS Group Total	6,999,685					
Alliance & Leicester	957	0.80%	S	Call		
Santander Group Total	957					
TOTAL INVESTMENTS	22,720,519					
PWLB	-800,000					
TOTAL LOANS	-800,000					
NET INVESTMENTS TOTAL	21,920,519					

S = Specified Investment - less than 1 year

NS = Non-specified investment - 1 year and over

The Council has £3m invested with Glitnir bank in Iceland. Repayment of this investment is subject to legal proceedings which are taking place in January 2011. The Council is represented by Bevan Brittan and the Local Government Association.

EXPLANATION OF PRUDENTIAL INDICATORS

Central government control of borrowing was ended and replaced with Prudential borrowing by the Local Government Act 2003. Prudential borrowing permitted local government organisations to borrow to fund capital spending plans provided they could demonstrate their affordability. Prudential indicators are the means to demonstrate affordability.

Table 1

Capital expenditure – shows last year's spending, this year's projected spending and the approved programme until 2013/14.

Ratio of financing costs to net revenue stream – because the council has no net debt investment interest on reserves and balances makes a positive contribution to both HRA and Non-HRA finances.

Net borrowing requirement – this demonstrates that no borrowing is planned to fund the capital programme.

In year capital financing requirement – this shows the £2.25m capitalisation of Icelandic investments.

Capital financing requirement (CFR) as at 31 March – the capital financing requirement shows the underlying need of the Council to borrow for capital purposes as determined from the balance sheet. The overall CFR of £0.832m shows that there is need to borrow.

Incremental impact of capital investment decisions – increase in Council Tax (band D) per annum – this indicator shows the affect of the latest capital programme report on annual council tax. This indicator is based on the estimated decrease or increase in interest payable to the General Fund each year due to the changed funding of the capital programme in the latest capital report to January cabinet as compared with the previous capital report in July.

Incremental impact of capital investment decisions – increase in average housing rent per week – this indicator shows the affect of the latest capital programme report on weekly housing rent. This indicator is based on the estimated decrease or increase in interest payable to the HRA each year due to the changed funding of the capital programme in the latest capital report to January cabinet as compared with the previous capital report in July.

Table 2

Authorised limit for external debt - this is the maximum limit for external temporary borrowing. This is the statutory limit determined under section 3(1) of the Local Government Act 2003. This limit is set to allow sufficient headroom for day to day operational management of cashflows. This has been increased to allow for a potential cashflow borrowing need associated with the canal project.

Operational boundary for external debt – this is set as the more likely amount that may be required for day to day cashflow. This has been increased to allow for cashflow borrowing associated with the canal project.

Upper limit for fixed and variable interest rate exposure – these limits allow the Council flexibility in its investment and borrowing options.

Upper limit for total principal sums invested for over 364 days – the amount it is considered can prudently be invested for period in excess of a year.

ECONOMIC BACKGROUND

Global economy

The sovereign debt crisis peaked in May 2010 prompted, in the first place, by major concerns over the size of the Greek government's total debt and annual deficit. However, any default or write down of Greek debt would have 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, in Ireland, occurred in November 2010.

The unexpectedly high rate of growth in quarter 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 not expected to be enduring; general expectations are for anaemic (but not negative) growth in 2011 in the western world.

UK economy

Following the general election in May 2010, the coalition government has put in place an austerity plan to carry out correction of the public sector deficit over the next five years. The inevitable 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 have started on a negative trend during the summer and autumn of 2010. Mortgage approvals are also at very weak levels and declining, all of which indicates that the housing market is likely to be very weak next year.

Economic Growth – GDP growth is likely to have peaked in the current period of recovery at 1.2% in quarter 2 of 2010. The first estimate of +0.8% for quarter 3 was also unexpectedly high. However, the outlook is for anaemic growth in 2011/12 although the Bank of England and the Office for Budget Responsibility are forecasting near trend growth (2.5%) which is higher than most other forecasters.

Unemployment – the trend of falling unemployment (on the benefit claimant count) has now 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 and has gradually declined to 3.1% in September (RPI 4.6%). Although inflation has remained stubbornly above the MPC's 2% target, the MPC is confident that inflation will fall back under the target over the next two years after another rise to near 3.5% by the end of 2010.

The Bank of England finished its programme of quantitative easing (QE) with a total of £200bn in November 2009. However, expectation that there could be a second round of quantitative easing in late 2010 or early 2011 to help support economic growth has evaporated after the surprises of the Q3 GDP figure of +0.8% and 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 Bank Rate until the middle of 2011.

AAA rating – prior to the general election, credit rating agencies had been issuing 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 budget on 22 June, Sterling has 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 has

helped to add downward pressure on gilt yields and PWLB rates. If there is a second round of QE, this is likely to put further downward pressure on gilt yields and so on PWLB rates, or at the least, prolong the period they stay at these low levels.

Sector's view of economic prospects

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 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 currency war and 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 and deleveraging, 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.