Report to: **Council**

Subject: **Treasury Management Strategy Statement and Annual Investment Strategy 2009/2010**

Date: **4 March 2009**

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PURPOSE OF REPORT

To seek Members' approval to the Council's Treasury Management Strategy Statement and Annual Investment Strategy for 2009/10.

BACKGROUND

Introduction

The Local Government Act 2003 requires the Council to have regard to the Prudential Code and to set indicators for the next three years, to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Act therefore requires the Council to set out its Treasury Management Strategy Statement (TMSS) for borrowing, and to prepare an Annual Investment Strategy (AIS) as required by Investment Guidance issued subsequent to the Act, setting out the Council's policies for managing its investments, and for giving priority to the security and liquidity of those investments. The ODPM (now CLG) investment guidance published in 2004 stated that authorities may combine the TMSS and the AIS into one report if they so choose, and the Council has adopted this approach.

The suggested strategy for 2009/10 in respect of the following aspects of the treasury management function is based upon the Head of Corporate Service's views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisors. The strategy covers:

1) Treasury limits in force which will limit the treasury risk and activities of the Council
2) Prudential indicators
3) The current treasury position
4) The borrowing requirement
5) Prospects for interest rates
6) The borrowing strategy

7) Debt rescheduling
8) The investment strategy
9) Other Issues (LSVT etc)

Members are reminded that the MRP Policy Statement for 2009/10 was reported to and approved by Council on 25 February 2009.

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:

i. Increases in interest and MRP charges caused by increased borrowing to finance additional capital expenditure, and
ii. Any increases in running costs arising from new capital projects

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

PROPOSAL

(1) Treasury Limits for 2009/10 to 2011/12

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”.

The Council must have regard to the Prudential Code when setting the “Authorised Limit”, which represents the affordable borrowing limit, and 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 is “acceptable”. Following the Large Scale Voluntary Transfer (LSVT) of the Council’s housing stock in November 2008, consideration of HRA matters is no longer relevant.

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 the two successive financial years.

2) Prudential Indicators for 2009/10 to 2011/12

The Prudential Code requires the Council to indicate whether it has adopted the Cipfa Code of Practice on Treasury Management. It is hereby confirmed that this Authority has adopted the Code.

Appendix 1 details the Prudential Indicators required for the purpose of setting an integrated Treasury Management Strategy. Council approved these indicators on 25 February 2009. Section 1 details those indicators that are based on estimates of expected outcomes, and includes four key indicators of affordability:

i. Ratio of financing costs to net revenue stream
ii. Incremental impact of capital investment decisions
iii. Capital expenditure
iv. Capital financing requirement (CFR)

Section 2 details those indicators that are based on limits, beyond which activities should not pass without management action. These include two indicators of affordability and five indicators of prudence:

Affordability

i. Authorised Limit for external debt (the “affordable borrowing limit”)
ii. Operational Boundary for external debt

Prudence

i. Net borrowing and the capital financing requirement (CFR)
ii. Upper limit for fixed interest rate exposure
iii. Upper limit for variable rate interest exposure
iv. Upper limits for the maturity structure of borrowing
v. Upper limit for principal sums invested for periods over 364 days

(3) Current Portfolio Position

The Council’s treasury portfolio position at 18 February 2009 is detailed below:

	£	Av Rate %
Fixed Rate Borrowing - PWLB	**8,514,500**	4.03
Total Investments	**(14,350,000)**	3.21
Net Borrowing / (Investment)	**(5,835,500)**	

(4) Borrowing Requirement

The Council’s estimated borrowing requirement to finance its capital programme for the current year, 2008/09, and its anticipated requirements for the years 2009/10 to 2011/12 are detailed below. Due to favourable interest rates, borrowing in advance of cash flow need, but within the capital financing requirement Prudential indicator, was undertaken during 2006/07 and 2007/08, therefore the borrowing “requirement” below differs to the actual borrowing undertaken.

Future Borrowing Requirement	2008/09 £m	2009/10 £m	2010/11 £m	2011/12 £m
Borrowing required for Capital Programme	0.0	1.5	1.1	1.4
Alternative Financing Arrangements	0.0	0.0	0.0	0.0
Total	**0.0**	**1.5**	**1.1**	**1.4**

(5) Prospects for Interest Rates

The Council has appointed Sector Treasury Services as its treasury advisors, and part of their service is to assist the Council to formulate a view on interest rates. Appendix 2 draws together the Sector central view and those of a number of leading city forecasters for short term or variable (Bank Rate) and longer term fixed interest rates.

Members' attention is drawn to the fact that all of Sector's forecasts follow the convention used by HM Treasury in its budget reports and statistics in as much as years are always calendar years, and not local authority financial years. Quarter 1 (Q1) therefore refers to the January to March quarter, not the first quarter of a local authority financial year, April to June.

Interest Rate Forecast:

Sector's current view on interest rates is that Bank Rate will fall from current levels because of the intensifying global recession. Starting 2009 at 2%, Bank Rate is forecast to fall to 0.5% in Q1 2009, and is then expected to remain at this level until starting to rise gently up from Q2 2010 until it reaches 4% in Q1 2012. There is downside risk to these forecasts if the recession proves to be deeper and more prolonged than currently expected.

Economic Background:

The sub-prime crisis of early 2008 was supplanted by the banking crisis of autumn 2008. The world banking system came near to collapse, and governments around the world were forced to recapitalise and rescue their major banks. The resulting dearth of lending from banks anxious to preserve capital led to economic forecasts being sharply reduced, and recession priced into markets. This in turn led to sharp falls in oil and other commodity prices with the result that inflation, which in the UK was running at 5%, became yesterday's story and recession fears drove interest rate sentiment and policy. A co-ordinated global interest rate cut of 50 basis points (bp) took place on 8 October 2008. Forecasts in the UK were for further sharp cuts in interest rates as recession hove into view.

International:

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

- *In mid-September, Lehman Brothers, the investment bank, was allowed to fail. This triggered a domino effect with other banks and financial institutions having to be rescued or supported by governments around the world.*
- *After the collapse into receivership of the Icelandic banks in early October, other countries then started to feel the strain and a number had to approach the IMF for support.*
- *Eventually, even the Asian "Tiger" economies were affected including India and China, and it became clear that the crisis had become a global one, and that no country was insulated from it.*
- *The financial crisis had therefore precipitated an economic crisis and there was a co-ordinated global interest rate cut with the Fed, ECB and MPC all cutting rates by 50bp on 8 October. The Fed subsequently cut rates again by 50bp to 1% on 29 October, and again on 16 December to a band of 0% to 0.25% in an attempt to stave off the coming recession. Inflation was "yesterday's problem".*
- *On 4 November, the US elected Barack Obama as President with little immediate financial impact.*
- *The ECB reduced rates again in November by 50bp, in December by its biggest ever cut of 75bp, in January by another 50bp to 2%, and then no change in February.*
- *As the pace of world recession quickened, so the price of oil plunged to around $40 per barrel by the end of 2008, and fears changed from being focussed on inflation to the potential dangers of deflation.*
- *On 11 February 2009, Congress passed a $789bn support package for the US economy and banking system. Financial markets were disappointed by the lack of detail as to how this programme was going to work.*

United Kingdom:

- *GDP growth was already slowing in 2008 from 2007, before the full impact of the credit crunch was felt. Earlier in 2008, GDP was 2.3% whereas in Q3 it fell to 0.3% and then fell by 1.5% in Q4 to give a year on year figure of –1.8%. GDP forecasts for 2009 are now in the -2.5% to –3.5% area.*
- *Wage inflation remained relatively subdued as the government kept a firm lid on public sector pay. Private sector wage growth was kept in check by the slowing economy.*
- *Growth slowed across the economy and the increase in unemployment accelerated towards the end of the year to very nearly break through the 2 million barrier in January 2009. Unemployment is expected to continue to rise towards 3 million in 2009.*
- *Bank lending came to a virtual standstill in the autumn of 2008 as the credit crunch tightened its grip and various banks internationally had to be rescued or supported by their governments.*
- *The Government and the Bank of England supplied massive amounts of liquidity to the banking market in an attempt to re-ignite longer Interbank lending.*
- *The Government announced in October a £500bn package of measures to support the banking system and the economy. This included £37bn to recapitalise some of the major clearing banks, and a requirement for the others to strengthen their capital ratios by their own fundraising efforts. The aim of this was to try to ensure that these banks would be seen to have*

sufficient reserves to last through the coming recession, with its inevitable increase in bad loans etc. However, a second bank support package proved necessary in January 2009.

- *The housing market also came to a virtual standstill as lenders demanded larger deposits and higher fees. House sales and prices both dropped sharply*
- *Government finances deteriorated as income from taxation dropped as the economy slowed and the cost of the bailout of the banks was added to the deficit.*
- *UK equity prices declined sharply in Q3 and Q4 of 2008 as the impending recession was priced into the markets. Prices hit five-year lows and volatility was extremely high.*
- *The story of 2008 has been the credit crunch, the banking crisis and the change in economic outlook from slow growth to outright recession. After the initial concerns about the impact of the credit crunch in the earlier part of 2008, it appeared as though the storm had been weathered. The MPC has been very concerned about CPI inflation, which had been rising sharply on the back of higher commodity and food prices. Bank rate reached a peak of 5.75% in July 2007 after which cuts of 0.25% occurred in December 2007 and February and April 2008 before the major cuts in the autumn. The economic data had been indicating a slowing economy for some while but was not sufficiently weak to force the MPC into another cut. It was the strength of the banking crisis, pre-empted by the collapse of Lehmans in New York that eventually drove the MPC to cut interest rates by 50bp on 8 October in concert with the Fed, the ECB and other central banks. It was then appreciated that the economic downturn would be much more severe than previously thought, and interest rates were subsequently slashed by 150bp in November, 100bp in December 2008, 50bp in January 2009 and another 50bp in February 2009, to reach 1%.*
- *The LIBOR spread over bank rate has also been a feature and a concern of 2008/09. Because of the credit crunch fears and the reluctance of lenders to place cash for long periods, 3 month LIBOR (London Interbank Offer Rate, or rate at which banks will lend to each other) has been substantially higher than Bank Rate. This has meant that the MPC's power over monetary policy has been eroded and it has therefore had a limited ability to bring relief to hard pressed borrowers through lower interest rates. However, the power of the Government over the semi-nationalised clearing banks had considerable impact in enforcing pro rata reductions to the 150bp Bank Rate cut in November on some borrowing rates*
- *The Government has abandoned its "Golden Rule". The Pre Budget Report on 14 November revealed the Government's plans for a huge increase in its borrowing over coming years as a result of falling tax revenues and also due to tax cuts and increases in Government expenditure in the short-term, designed to help stimulate economic growth to counter the recession.*
- *UK bank shares nose-dived in mid January 2009, stoked by particular concerns around RBS incurring the largest deficit in UK corporate history of £28bn as it wrote off huge sums for overpaying for the purchase of the Dutch bank AMRO at the height of the market. This was the catalyst for the Government stepping in with a second bank support package including a £250bn insurance scheme for toxic assets on bank balance sheets, to put a floor on the amounts banks could lose on the. Various other measures were also announced.*

- *The Bank of England's inflation report of 11 February 2009 confirmed fears that the recession is going to be deeper and longer than previously thought. CPI inflation was forecast to dip to 0.5% in 2 years time, arousing fears that CPI could get into negative territory, ie. deflation, if economic conditions worsened more than currently expected. The governor of the Bank of England emphasised that further Bank Rate cuts would not be sufficient to counter this recession, and that "Quantitative Easing" would be required, ie. the use of unconventional methods to increase liquidity in the economy, to promote the expansion of credit and so economic growth. The Bank of England therefore proposes to start purchases of corporate bonds and gilts.*
- *There are concerns as to how, and how quickly, the above two programmes by the Bank and the Government will be translated from being just concepts into actual action. There is also concern that any action may err on the side of caution and so prove to be insufficient to stem the tide of recession as quickly as might otherwise be possible. There are similar concerns for the parallel programmes in the US.*

(6) Borrowing Strategy

Sector's view on the borrowing strategy is as follows. These forecasts are based around an expectation that there will normally be variations of +/-25 basis points during each quarter around these average forecast in normal economic and political circumstances. However, greater variations can occur should there be any unexpected shocks to financial and/or political systems. These forecasts are for the PWLB "new borrowing" rate.

External Borrowing:

- *The 50-year PWLB rate is expected to be around 3.9% to 3.95% for most of 2009/10, and then to rise gradually to reach 4.45% in Q1 2011. The rate then edges up gradually to reach 5.05% in Q1 2012.*

- *The 25-year PWLB rate is expected to be between 4% and 4.1% during 2009/10 and then to start gradually rising in 2010/11 to reach 4.6% in Q1 2011. In 2011/12 the rise is expected to continue, to reach 5.1% in Q1 2012.*

- *The 10-year PWLB rate is expected to drop to a floor of 3.2% in Q3 2009 but then to start rising again in Q1 2010 to reach 4.3% in Q1 2011 and then to continue rising to reach 4.9% in Q1 2012.*

- *The 5-year PWLB rate is expected to fall to a floor of 2.3% during Q3 2009. The rate then starts rising in Q2 2010 to reach 3.65% in Q1 2011, and then to continue rising to reach 4.6% in Q1 2012.*

This forecast indicates, therefore, that there is a range of options available for borrowing strategy for 2009/10. Variable rate borrowing is expected to be cheaper than long-term borrowing, and will therefore be attractive throughout the financial year compared to simply taking long-term fixed rate borrowing. Under 10 year PWLB rates are expected to be substantially lower than longer-term PWLB rates, so this will open up a range of choices for new borrowing for authorities that want to spread their debt maturities away from a concentration in long-dated debt. Rates are

expected to be slightly lower at the middle to end of the year than earlier on, therefore it may be advantageous to borrow later in the year.

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For authorities wishing to minimise their debt interest costs, the main strategy is therefore as follows:

- *For authorities wanting to focus on the very cheapest PWLB borrowing, the under 10-year rates will provide significantly cheaper rates than longer-term borrowing. Under 5-year rates are also expected to be significantly lower than 5-10 year rates. Rates are expected to be slightly lower at the middle to end of the year than earlier on, so it may be advantageous to borrow later in the year.*
- *For authorities wishing to lock into historically low long-term rates, there is expected to be little difference between the 25-year and 50-year rates. However, despite minimally more expensive new borrowing rates expected in the 25-30 year period later in the year, these could be seen as being much more attractive than 50-year borrowing, as the spread between the PWLB new borrowing and early repayment rates is considerably less. This then maximises the potential for debt rescheduling at a later time by minimising the spread between the two rates.*
- *This strategy would also mean that after some years of focussing on borrowing at or near the 50-year period, local authorities would be able to undertake borrowing in a markedly different period and so achieve a better spread in their debt maturity profile.*
- *When long-term PWLB rates fall back to the central forecast rate of about 4%, borrowing should be made at any time in the financial year. A suitable trigger point for considering new fixed rate long-term borrowing, therefore, would be 4%. The central forecast rate will be reviewed in the light of movements in the slope of the yield curve, spreads between PWLB new borrowing and early payment rates, and any further changes the PWLB may introduce to their lending policy and operations.*
- *Consideration will also be given to borrowing fixed-rate market loans at 25-50 basis points below the PWLB target rate if they become available again.*

External versus Internal Borrowing:

- *The next financial year is expected to be at time of historically abnormally low Bank Rate. This opens up an opportunity for authorities to fundamentally review their strategy of undertaking external borrowing.*
- *For those authorities with investments in excess of their borrowing requirement over the next year, and access to cash from maturing investments within the financial year, then consideration also needs to be given to the potential merits of internal borrowing.*
- *As long-term borrowing rates are expected to be higher than rates on the loss of investment income, and look likely to be so for the next couple of years or so, authorities may prefer to avoid all new external borrowing in the next financial year, in order to maximise savings in the short term.*
- *The running down of investments also has benefits of reducing exposure to interest rate and credit risk.*

Against this background, considerable caution will be adopted with regard to 2009/10 treasury operations. In order to avoid risk and to maximise short-term savings, it is

envisaged that maturing investments will be utilised in preference to undertaking new borrowing. However, this strategy will inevitably result in a degree of temporary borrowing being required to bridge gaps in cashflow. Regular advice will be taken from Sector, and should suitable opportunities arise, borrowing in advance of need for future years may be undertaken.

The Head of Corporate Services will monitor the interest rate market and will adopt a pragmatic approach to changing circumstances, reporting any decisions to Cabinet at the next available opportunity.

Sensitivity of the Forecast – in normal times, the main sensitivities of the forecast are likely to be the two scenarios below. Officers, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

- If it was felt that there was a significant risk of a sharp rise in long-term and short-term rates, perhaps arising from a greater than expected increase in world economic activity, or further increases in inflation, then the portfolio position will be reappraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

- If it was felt that there was a significant risk of a sharp fall in long-term and short-term rates, eg. due to growth rates weakening, then long term borrowing will be postponed, and potential rescheduling from fixed rate funding into short term funding will be considered.

After the freezing of some local authority investments by Icelandic banks now in receivership, many local authorities are currently concerned about the safety of investments, and their ability to rely on credit ratings for ensuring that investments can be undertaken safely, especially for longer periods. The Council's approach to this issue is to remain extremely cautious, and to accept only counterparties with the very highest credit ratings.

(7) Debt Rescheduling

The introduction on 1 November 2007 of different PWLB rates for new borrowing as opposed to the early repayment of debt, and the setting of a spread between the two rates (of about 40-50 basis points for the longest period loans, narrowing down to 25-30 basis points for the shortest loans), has meant that PWLB to PWLB debt restructuring is now much less attractive than before that date. However, significant interest savings will still be achievable through using LOBOs (Lender Option Borrower Option) loans and other market loans if these again become available, after their virtual disappearance during the turbulence of autumn 2008.

Due to the expectation that short-term borrowing rates will be considerably cheaper than longer-term rates, there are likely to be significant 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 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. Any such rescheduling and repayment of debt is likely to cause a rebalancing of an authority's debt maturities

towards a flattening of the maturity profile, as in recent years there has been a skew towards longer dated PWLB.

Consideration will also be given to the potential for making savings by running down investment balances by repaying debt prematurely, as short- term rates on investments are likely to be lower than rates paid on currently held debt. However, this will need careful consideration in the light of premia that may be incurred by such a course of action, and other financial considerations.

As average PWLB rates in some maturity periods are likely to be minimally higher early on in the financial year than later on, there should therefore be greater potential for making marginally higher interest rate savings on debt by doing debt restructuring earlier on in the year. Any positions taken via rescheduling will be in accordance with the borrowing strategy position outlined in paragraph 6 above.

The reasons for any rescheduling to take place will include:

- The generation of cash savings and/or discounted cashflow savings, at minimum risk
- In order to help fulfil the strategy outlined in paragraph 6 above
- In order to enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility)

All rescheduling will be reported to Cabinet at the meeting following its action.

(8) Annual Investment Strategy

(a) Investment Policy

<u>(i) Investment Principals</u>

The Council will have regard to the ODPM (now CLG) guidance on Local Government Investments ("the guidance") issued in March 2004, and Cipfa's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the Cipfa TM Code").

All investments will be made in sterling, and the Council's general policy objective is the prudent investment of its treasury balances.

The Council's investment priorities are:

- The liquidity of its investments

  Based on its cashflow forecasts, the Council anticipates its fund balances in 2009/10 to range between £0m and £10m. Giving due consideration to the Council's level of balances over the next five years, the need for liquidity, its spending commitments and provisioning for contingencies, the Council has determined that a maximum of £3m may be held in non-specified investments during the year. Appendix 3 sets out the maximum periods for which funds may be prudently committed in each asset category.

- The security of capital

  The credit quality of counterparties and investment schemes will be determined by reference to credit ratings published by Fitch. The Council has also established the minimum long and short-term and other credit ratings that it considers “high” for each category of investment. All ratings will be monitored monthly, and the Council is alerted to changes in Fitch ratings by email from Sector. If a downgrade results in the counterparty or investment scheme no longer meeting the Council’s minimum criteria, its approval for further investment use will be withdrawn immediately. If a counterparty or investment scheme is upgraded so that it fulfils the Council’s criteria, the Head of Corporate Services will have the discretion to include it on the lending list.

  Since the credit crunch crisis there have been a number of developments that require consideration.

- Nationalised banks in the UK have credit ratings that do not conform to the credit criteria normally used by local authorities. In particular, as they are no longer separate institutions in their own right. Fitch cannot therefore assign such institutions an individual rating for their stand-alone strength. However, these institutions effectively take on the creditworthiness of the Government itself, therefore having the highest rating possible. Accordingly, Cabinet on 10 February 2009 approved the recommendation of the Head of Corporate Services to allow the continued use of HBOS/Bank of Scotland on this basis. Further requests of this nature may be made as appropriate.

- Some countries have supported their banking systems by giving a blanket guarantee on all deposits, eg. Ireland. Some authorities may take the view that the sovereign rating of the country takes precedence over individual credit ratings, however the Head of Corporate Services considers that since the economies of the countries affected are facing similar, if not worse, pressures than our own, the use of counterparties in these areas is not appropriate at this time.

- The UK Government has not given a blanket guarantee on deposits, but has underlined its determination to ensure the security of the UK banking system by supporting 8 named banks with a £500bn support package. These are Abbey, Barclays, HBOS, Lloyds TSB, HSBC, Nationwide Building Society, RBS and Standard Chartered.

The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The borrowing of monies purely to invest or on-lend and make a return remains unlawful, and the Council will not engage in such activity.

(ii) Specified and Non-Specified Investments

Investment instruments identified for use in the financial year are listed at Appendix 3 under “Specified” and “Non-Specified” categories. “Specified” investments will generally be used for cash-flow management, and non-specified” for the longer-term

investment of core balances. Counterparty limits will be as set out in the Council's Treasury Management Practices (Schedules). Appendix 3 also sets out:

- The advantages and associated risk of investments under the non-specified category
- The upper limit to be invested in each non-specified category
- Which instruments would best be used after consultation with the Council's treasury advisors

(iii) Investments defined as capital expenditure

The acquisition of share capital or loan capital in a body corporate is defined as capital expenditure under regulation 25(1)(d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003. Such investments will have to be funded out of capital or revenue resources, and will be classified as non-specified investments. Investments in "money market funds", which are collective investment schemes, and bonds issued by "multilateral development banks", both defined in SI 2004 No 534, will not be treated as capital expenditure. A loan or grant or financial assistance by this Council to another body for capital expenditure by that body will be treated as capital expenditure.

(iv) Provisions for credit-related losses

If any of the Council's investments appear to be at risk of loss due to default, ie this is a credit-related loss and not one resulting from a fall in price due to movements in interest rates, the Council will make revenue provision of an appropriate amount.

(b) Investment Strategy

(i) In-house strategy

The Council's in-house managed funds are mainly cashflow derived, however, there is a core balance available, which may be invested over a 2-3 year period if appropriate. Given the borrowing strategy above, it is envisaged that core balances will be significantly utilised during 2009/10. Investments will accordingly be made with careful reference to the core balance and cashflow requirements, and the outlook for short-term interest rates (ie. for investments up to 12 months). As at 18 February 2009 the Council does not hold any investments spanning the whole of the forthcoming financial year 2009/10, ie. maturing beyond 31 March 2010.

(ii) Interest Rate Outlook

The Bank Rate started on a downward trend from 5.75% with the first cut to 5.5% in December 2007, with further cuts of 0.25% in February and April 2008, then 0.5% in October 2008, 1.5% in November 2008 and 1% in December 2008. Cuts of 0.5% were also made in January and February 2009, bring Bank Rate to 1%. A further cut of 0.5% is expected during Q1 of 2009 and the rate is then expected to stabilise at 0.5% until starting to rise gradually with the first increase in Q2 2010, and then back up to 4% during Q1 of 2012. Councils should therefore avoid locking into longer-term deals whilst investment rates are adown at historically low levels.

For its cashflow generated balances, the Council will seek to use its corporate deposit accounts and short-dated fixed term deposits (1-3 months).

For 2009/10, Sector recommends that the Council should budget for an investment return of 1.5% on investments placed during 2009/10. Given the likely use of significant core investments rather than new borrowing, the Council has taken a slightly more pessimistic view, and an equated return of around 1.1% has been included in the revenue budgets for 2009/10

(iii) End of Year Investment Report

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

(9) Other Issues

(a) Large Scale Voluntary Transfer (LSVT)

The LSVT of the Council's housing stock to Gedling Homes took place on 3 November 2008 following consideration of numerous complex and critical issues. Following a second stock condition survey the stock was finally transferred with an obligation on Gedling Homes to undertake some £68m worth of improvements on the Council's behalf. Accordingly, no capital receipt was generated by the Council, however £3.95m of overhanging HRA debt was redeemed on the Council's behalf by CLG. Approximately 32% of each loan was "topsliced" by CLG, reducing the outstanding PWLB debt from £2.5m to £8.55m.

(b) Investments in Icelandic Banks

The Icelandic Government has stated its intention to honour all its commitments as a result of their banks being placed into receivership. The UK Government informed local authorities in November 2008 that it intends to make a regulation to require local authorities to delay recognising any losses that may eventually be incurred on these investments, until the financial year 2010/11.

The Council held no investments in any Icelandic bank at the time of the collapse, and is not therefore affected by this proposed regulation.

RECOMMENDATIONS

Members are asked to:

Approve the Treasury Management Strategy Statement and Annual Investment Strategy (TMSS & AIS) for 2009/10.