APPENDIX 1

CHERWELL DISTRICT COUNCIL

Treasury Management Strategy

Annual Investment Statement

2011/12

1. Introduction

1.1 Background

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. "

1.2 Statutory requirements

The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the 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.

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 subsequent to the Act and included as paragraph 9 of this report); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The Department of Communities and Local Government has issued revised investment guidance which came into effect from 1 April 2010. There were no major changes required over and above the changes already required by the revised CIPFA Treasury Management Code of Practice 2009.

1.3 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 1st March 2002.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.
4. 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.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated bodies are the Executive Committee and Accounts, Audit and Risk Committee

1.4 Treasury Management Strategy for 2011/12

The suggested 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 adviser, Sector Treasury Services.

The strategy covers:

- treasury limits in force which will limit the treasury risk and activities of the Council
- Prudential and Treasury Indicators
- the current treasury position
- the borrowing requirement
- prospects for interest rates
- the investment strategy
- creditworthiness policy
- policy on use of external service providers

1.5 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: -

1. increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
2. 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.

2. The Borrowing Requirement

The Council is debt free and has no plans to enter into any long term debt arrangements. As such this section is irrelevant for the 2011/12 Treasury Management Strategy. This would be reviewed in subsequent years if there was a decision to go back into debt.

3. Prudential and Treasury Indicators for 2011/12 – 2013/14

Prudential and Treasury Indicators (Appendix 1 to this report) are relevant for the purposes of setting an integrated treasury management strategy. These indicators were approved by the Council as part of the 2011/12 Budget process on 21st February 2011.

The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The Code was adopted on 1st March 2002 by the full Council

4. Prospects for Interest Rates

The Council has appointed Sector Treasury Services as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates. Appendix 2 draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Sector central view.

Sector Bank Rate forecast for financial year ends (March)

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

There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected. A detailed view of the current economic background is contained within Appendix 3 to this report.

5. Annual Investment Strategy

5.1 Investment Policy

The Council will have regard to the CLG's 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 priorities are: -

(a) the security of capital
(b) the liquidity of its investments.
(c) the yield on the investments

The Council will 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 its investments

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.

Investment instruments identified for use in the financial year are listed in Appendix 4 under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Appendix 6.

5.2 Creditworthiness policy

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 and 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
- CDS spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which 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 now gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.

The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Sector's weekly credit list of worldwide potential counterparties. The Council will therefore use counterparties within the following durational bands

- Yellow 5 years for UK Government backed securities and Local Authorities
- 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

This Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties as Moodys tend to be more aggressive in giving low ratings than the other two agencies. This would therefore be unworkable and leave the Council with few banks on its approved lending list. The Sector creditworthiness service does though, use ratings from all three agencies, but by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

All credit ratings will be monitored weekly. The latest counterparty list can be seen in Appendix 1G. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

- If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- In addition to the use of Credit Ratings, Sector will advise the Council of information in movements in Credit Default Swap 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.

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

5.3 Country limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of *AA-* from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). The list of countries that qualify using this credit criteria as at the date of this report are shown in appendix 5. This list will be added to or deducted from by officers should ratings change in accordance with this policy.

In the current economic climate, officers have not placed deposits with overseas banks or Money Market Funds and have only dealt with UK institutions, although the authority to use overseas banks and Money Market Funds would be granted by approving the annual investment strategy. This approach is under constant review, and could change should officers feel that in doing so it would not comprise the security or liquidity of the Council's investment portfolio.

5.4 Investment Strategy

In-house funds: The Council has in-house managed funds which are mainly cash-flow derived and there is a core balance available for investment over a longer period. Investments will accordingly be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

External fund managers

Currently £42.5m (63%) of the Council's funds are externally managed on a discretionary basis by Investec and Tradition UK. The Council has used external fund managers since 1997. These fund managers and amounts held are currently under review as we look to rebalance funds as expenditure in our capital programme continues. Treasury was subject to a value for money review in December 2010 so we are also looking to reduce the costs in this area.

The Council's external fund managers will comply with the Annual Investment Strategy. The agreement between the Council and Investec additionally stipulate guidelines and duration and other limits in order to contain and control risk.

The minimum credit criteria to be used by Investec is as follows: -

	Fitch	Moodys	Standard and Poors
Long Term	A	A2	A
Short Term	F1	P-1	A-1
Individual/Financial Strength	B or C	C	N/A
Support	3 or 2	N/A	N/A

(The combination of Fitch ratings above is either B3 or C2)

All investments held with Investec can be liquidated immediately if required and do not have to be held to maturity. Obviously there may be a cost implication which would impact on the total returns.

The Council currently has investments which span the financial year

	Category	Amount	Maturity	Rate
Nationwide BS	External	£3,000,000	06/06/2011	1.15%
Bank of Scotland	External	£5,000,000	26/07/2011	2.05%
Ulster Bank	In-house	£3,000,000	11/08/2011	1.48%
Clydesdale Bank	In-house	£5,000,000	250/8/2011	1.70%
Lloyds Bank	External	£1,500,000	02/09/2011	1.90%
Barclays Bank	External	£5,000,000	28/10/2011	6.35%
Lloyds Bank	In-house	£4,000,000	02/03/2012	1.74%
Barclays	External	£3,000,000	01/05/2012	2.50%
Bank of Scotland	External	£2,500,000	16/11/2012	2.45%

Local Authority Mortgage Guarantee Scheme

An opportunity has arisen for the Council to participate in the Local Authority Mortgage Guarantee Scheme (LAMGS) and may be used to assist the Housing Service meet its strategy. The Council would be required to place a deposit with the mortgage provider(s) up to the full value of the guarantee. The deposit will be in place for the term of the guarantee i.e. 5 years (with the possibility of a further 2 year extension if the account is 90+ days in arrears at the end of the initial 5 years) - and may have conditions/structures attached. The mortgage provider will not hold a legal charge over the deposit. Each application would be considered on a case by case basis and would need to be authorised by Portfolio Holder for Planning and Housing, Portfolio Holder for Resources, Head of Housing and Chief Financial Officer.

Interest rate outlook: Bank Rate has been unchanged at 0.50% since March 2009. Bank Rate is forecast to commence rising in quarter 3 of 2011 and then to rise gently from thereon. Bank Rate forecasts for financial year ends (March) are as follows: -

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

There is downside risk to these forecasts if economic growth is weaker and slower than expected. There is also a risk that the MPC could decide to start raising Bank Rate in quarter 2 of 2011 if it feels it needs to defend its credibility in containing inflation and the inflation expectations of the public.

The Council will avoid locking into longer term deals while investment rates are down at historically low levels unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile and within the risk parameters set by this council.

The suggested budget for investment returns on investments placed for periods less than three months during each financial year is as follows: -

2011/12	1.10%
2012/13	2.10%
2013/14	3.30%
2014/15	4.10%
2015/16	4.50%

For its cash flow generated balances, the Council will seek to utilise its business reserve accounts, 15 day accounts, money market funds and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

Notwithstanding any of the above, should the Council be presented with an investment opportunity throughout the year which, while breaches the terms of this strategy, is considered by the Portfolio Holder of Resources and Chief Financial Officer to be too much of an attractive offer for the Council not to take advantage of, we will enter in to that deal. This would only be done with the express prior confirmation from the Portfolio Holder of Resources and Chief Financial Officer and would not in anyway compromised the Councils beliefs of Security, Liquidity, and Yield. This decision would be presented to the Finance Scrutiny Committee at the earliest opportunity.

5.5 End of year investment report

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

5.6 Policy on the use of external service providers

The Council uses Sector Treasury Services as its external 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 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 subjected to regular review.

5.7 Scheme of delegation

5.7.1 Full council

- receiving and reviewing reports on treasury management policies, practices and activities
- approval of annual strategy.

5.7.2 Executive

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices
- budget consideration and approval
- approval of the division of responsibilities
- approving the selection of external service providers and agreeing terms of appointment.

5.7.3 Accounts Audit & Risk Committee

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.
- receiving and reviewing regular monitoring reports and acting on recommendations

5.8 Role of the Chief Financial Officer (Section 151 officer)

The S151 (responsible) officer

- 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.

Appendices

1A Prudential and Treasury indicators

1B Interest rate forecasts

1C Economic background

1D Specified and non specified investments

1E Approved countries for investments

1F Glossary

1G Counterparty List (latest)

2 Treasury Management Practices (TMP`s)

APPENDIX 1A Prudential and Treasury Indicators

The Council's capital expenditure plans are summarised below and this forms the first of the prudential indicators. This total expenditure can be paid for immediately by resources such as capital receipts, capital grants etc. However, where these resources are insufficient any residual expenditure will form a borrowing need.

The summary capital expenditure projections are shown below and this forms the first prudential indicator:

	2009/10 Actual £000s	**2010/11 Estimated £000s**	**2011/12 Estimated £000s**	**2012/13 Estimated £000s**	**2013/14 Estimated £000s**
Capital Expenditure 11/12 approved	17,676	5,582	13,923	5,704	599
Financed by:					
Capital receipts	(16,897)	(4,907)	(11,926)	(5,306)	(599)
Capital grants	(455)	(375)	(375)	-	-
Revenue funded reserves	(60)	(300)	**(1,622)**	(398)	-
Direct Revenue Financing	**(264)**	**-**	**-**	**-**	**-**
Net financing need for the year	**-**	**-**	**-**	**-**	**-**

The Council's Borrowing Need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of Council's underlying borrowing need. The Council is required to pay off an element of the accumulated General Fund capital spend each year through a revenue charge (the Minimum Revenue Provision), although it is also allowed to undertake additional voluntary payments.

The Council is debt free and has no plans to enter into any long term debt arrangements. As such this section is largely irrelevant but is included for completeness if there was a decision to go back into debt. Therefore, the Council has a nil Minimum Revenue Provision for 2011/12.

The Council is asked to approve a NIL CFR projection as in the following table:

Capital Financing Requirement	2009/10 Actual £000s	2010/11 Estimated £000s	2011/12 Estimated £000s	2012/13 Estimated £000s	2013/14 Estimated £000s
Capital Financing Requirement:					
Total CFR	-	-	-	-	-
Movement in CFR	-	-	-	-	-
Movement in CFR represented by:					
Net financing need for the year (above)	-	-	-	-	-
MRP/VRP and other financing movements	-	-	-	-	-
Movement in CFR	-	-	-	-	-

The Use of the Council's resources and the Investment Position

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources	2009/10 Actual £000s	2010/11 Estimated £000s	2011/12 Estimated £000s	2012/13 Estimated £000s	2013/14 Estimated £000s
Fund balances	(1,777)	(1,200)	(1,200)	(1,200)	(1,200)
Capital receipts	(46,290)	(37,728)	(23,805)	(18,101)	(17,502)
Earmarked reserves	(7,070)	(6,820)	(6,820)	(6,820)	(6,820)
Total Core Funds	(55,137)	(45,748)	(31,825)	(26,121)	(25,522)
Working Capital*	(9,382)	(9,382)	(9,382)	(9,382)	(9,382)
Expected Investments	**(64,519)**	**(55,130)**	**(41,207)**	**(35,503)**	**(34,904)**

* Working capital balances are estimated year end; mid year may be higher

Limits to Borrowing Activity

Within the prudential indicators there are a number of key indicators to ensure the Council operates its activities within well defined limits.

For the first of these the Council needs to ensure that its total borrowing net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2010/11 and the following two financial years.

Borrowing	2009/10 Actual £000's	2010/11 Estimated £000's	2011/12 Estimated £000's	2012/13 Estimated £000's	2013/14 Estimated £000's
Gross Borrowing	-	-	-	-	-
Investments	(64,519)	(55,130)	(41,207)	(35,503)	(34,904)

Net Borrowing	(64,519)	(55,130)	(41,207)	(35,503)	(34,904)
CFR	-	-	-	-	-

The Chief Finance Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

A further two prudential indicators control or anticipate the overall level of borrowing. These are:

- The Authorised Limit for External Debt – This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by full Council.
- The Operational Boundary for External Debt –This indicator is based on the expected maximum external debt during the course of the year; it is not a limit.

The Council operates under the following Authorised Limit and Operational Boundary:

Authorised limit	**2009/10 Actual £000s**	**2010/11 Estimated £000s**	**2011/12 Estimated £000s**	**2012/13 Estimated £000s**	**2013/14 Estimated £000s**
Borrowing	10,000	10,000	10,000	10,000	10,000
Other long term liabilities	500	500	500	500	500
Total	10,500	10,500	10,500	10,500	10,500
Operational Boundary	**2009/10 Actual £000s**	**2010/11 Estimated £000s**	**2011/12 Estimated £000s**	**2012/13 Estimated £000s**	**2013/14 Estimated £000s**
Borrowing	-	-	-	-	-
Other long term liabilities	-	-	-	-	-
Total	-	-	-	-	-

Affordability Prudential Indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. The Council is asked to approve the following indicators:

Actual and Estimates of the ratio of financing costs to net revenue stream – This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of interest against the net revenue stream. Since becoming debt free the indicator is negative because the Council has no borrowing but carries substantial investments.

	2009/10 Actual %	**2010/11 Estimated %**	**2011/12 Estimated %**	**2012/13 Estimated %**	**2013/14 Estimated %**
Non-HRA	-	-	-	-	-

Estimates of the incremental impact of capital investment decisions on the Council Tax – This indicator identifies the revenue costs associated with ***new schemes*** introduced to the three year capital programme recommended in the budget report compared to the Council's existing approved commitments and current plans.

Incremental impact of capital investment decisions on the Band D Council Tax

	2011/12	2012/13	2013/14
Council Tax - Band D	£0.36	(£0.25)	(£0.50)

Treasury Management Prudential Indicators and Limits on Activity

The Council then has three further treasury prudential indicators:

	2011/12	2012/13	2013/14
Interest rate Exposures			
	Upper	Upper	Upper
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	40%	40%	40%
Maturity Structure of fixed interest rate borrowing 2011/12			
	Lower	Upper	
Under 12 months	0%	100%	
12 months to 2 years	0%	0%	
2 years to 5 years	0%	0%	
5 years to 10 years	0%	0%	
10 years and above	0%	0%	
Maximum principal sums invested > 364 days			
Principal sums invested > 364 days	£m 0	£m 0	£m 0

APPENDIX 1B Interest Rate Forecasts

The data below shows a variety of forecasts published by a number of institutions. The first three are individual forecasts including those of UBS and Capital Economics (an independent forecasting consultancy). The final one 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 – 21.2.11

	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%	0.75%	1.00%	1.00%	1.25%	1.50%	2.00%	2.25%	2.50%	3.00%	3.25%	3.25%
3 month LIBID	0.70%	0.80%	1.00%	1.25%	1.50%	1.75%	2.00%	2.25%	2.50%	3.00%	3.25%	3.50%	3.50%
6 month LIBID	1.00%	1.10%	1.20%	1.50%	1.80%	2.10%	2.40%	2.60%	2.80%	3.20%	3.50%	3.80%	4.00%
12 month LIBID	1.50%	1.60%	1.80%	2.10%	2.40%	2.70%	3.00%	3.10%	3.20%	3.40%	3.70%	4.00%	4.20%
5yr PWLB rate	3.70%	3.70%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.50%	4.60%	4.70%	4.80%
10yr PWLB rate	4.90%	4.90%	4.90%	4.90%	4.90%	5.00%	5.10%	5.20%	5.20%	5.30%	5.40%	5.40%	5.50%
25yr PWLB rate	5.40%	5.40%	5.40%	5.40%	5.40%	5.50%	5.50%	5.50%	5.50%	5.60%	5.60%	5.70%	5.70%
50yr PWLB rate	5.40%	5.40%	5.40%	5.40%	5.40%	5.50%	5.50%	5.50%	5.50%	5.60%	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%

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 February 2011

The current Q4 2011 and Q4 2012 forecasts are based on the February 2011 report. Forecasts for 2011 – 2015 are based on 32 forecasts in the quarterly forecast for February 2011.

BANK RATE FORECASTS		quarter ended		annual average Bank Rate				
	actual	Q4 2011	Q4 2012	ave. 2011	ave. 2012	ave. 2013	ave. 2014	ave. 2015
Median	0.50%	1.00%	2.00%	0.80%	1.50%	2.40%	3.20%	3.70%
Highest	0.50%	2.00%	3.50%	2.10%	2.80%	3.10%	4.30%	5.00%
Lowest	0.50%	0.50%	0.50%	0.50%	0.50%	0.60%	1.20%	2.00%

APPENDIX 1C Economic Background

3.1 Global economy

The Eurozone 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, this time over Ireland in November, culminated in Ireland also having to take a bail out. There was another crisis in early January 2011 when Portugal narrowly avoided having to resort to taking a similar bail out package. However, this looks as if Portugal has only delayed what appears to be inevitable so there are widespread expectations that there will be another sovereign debt crisis in 2011.

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 not expected to be enduring; general expectations
are for anaemic (but not negative) growth in 2011 in the UK and EU, though growth in the US looks as if it could be about twice as strong on the back of fiscal cuts increasing consumer disposable income and confidence.

3.2 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 from 2010. Mortgage approvals are also at very weak levels and declining, all of which indicates that the housing market is likely to remain weak in 2011.

Economic Growth – GDP growth has peaked in the current period of recovery at 1.2% in quarter 2 of 2010. Growth in quarter 3 @ +0.7% was also unexpectedly high but the first estimate for Q4 was a huge shock at -0.5% and reflected the effect of snow in December. Overall, the outlook is for anaemic growth in 2011/12 and the Bank of England has downgraded its estimate for growth in 2011 from 2.6% to 2.0% in the February 2011 Inflation Report.

Unemployment – the trend for 2011 is likely to be one of steadily increasing unemployment.

Inflation and Bank Rate – CPI has remained high during 2010. It peaked at 3.7% in April and then gradually declined to 3.1% in September (RPI 4.6%) before returning to a rising path and hitting 4.0% in January 2011. The outlook is for further upward pressure with CPI to reach as much as 5% in early 2011 before starting to subside again. Although inflation has remained stubbornly above the MPC's 2% target, the MPC is confident that inflation will fall back over the next two years and should then be near to the target level.

The Bank of England finished its programme of quantitative easing (QE) with total purchases of £200bn by November 2009. However, major expectation that there could be a second round of quantitative easing in late 2010 or early 2011, to help support economic growth, evaporated after the surprises of the Q3 GDP figure of +0.7% and the November Inflation Report revising the forecast for short term inflation sharply upwards.

Sector's central view is that Bank Rate will start to increase in Q3 2011 (August) but there are risks both ways on this timing

AAA rating – prior to the general election, credit rating agencies had been issuing repeated warnings that unless there was a major fiscal contraction, the UK's 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 2010, Sterling strengthened against the US dollar and confidence has returned that the UK will retain its AAA rating. In addition, international investors viewed UK government gilts as being a safe haven from EU government debt during mid 2010. The consequent increase in demand for gilts helped to add downward pressure on gilt yields and PWLB rates during the first half of 2010/11.

3.3 Sector's forward view

It is currently difficult to have confidence as to exactly how strong UK economic growth is likely to be during 2011/12, 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 strength / weakness of economic growth 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 adequately 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, in the US, for more quantitative easing, and the timing of this, and its subsequent reversal in both the US and UK
- 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
- political risks in the Arab world, Middle East and Korea and the knock on potential effects on oil production in the first two areas

The overall balance of risks is weighted to the downside. However, concerns around some residual risk of a double dip recession and deleveraging, creating a downward spiral of falling demand, falling jobs and falling prices, have now been replaced with concerns around the inflationary effects of increases in world commodity prices stoking the fires of inflation.

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. However, most of this increase has already occurred in the second half of 2010/11 as a result of a major change in market sentiment.

APPENDIX 1D Specified and Non-Specified Investments

SPECIFIED INVESTMENTS:
(All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' rating criteria where applicable)

	*** Minimum 'High' Credit Criteria**	**Use**
Debt Management Agency Deposit Facility	n/a	In-house
Term deposits – local authorities	n/a--	In-house
Term deposits – banks and building societies **	Green	In-house/Tradition
Term deposits – banks and building societies **	* Short-term F1__, Long-term _A_, Individual _B or C_, Support _3 OR 2_	Investec

Since the credit crunch crisis there have been a number of developments which require separate consideration and approval for use: -

Banks eligible for support under the UK bail-out package and which have issued debt guaranteed by the Government are eligible for a continuing Government guarantee when debt issues originally issued and guaranteed by the Government mature and are refinanced. However, no other institutions can make use of this support as it closed to new issues and entrants on 28.2.10. The banks which have used this explicit guarantee are as follows: -

- Bank of Scotland
- Barclays
- Clydesdale
- Coventry Building Society
- Investec bank
- Nationwide Building Society
- Rothschild Continuation Finance plc
- Standard Life Bank
- Tesco Personal Finance plc
- Royal Bank of Scotland
- West Bromwich Building Society
- Yorkshire Building Society

LIMITS:

	* Minimum Credit Criteria	Use	*** Max £	Max. maturity period
Term Deposits – Local Authorities	--	In-house	**£10m**	**364 days**
UK nationalised banks	green	In-house /Tradition	**£15m**	**364 days**
UK nationalised banks	* Short-term F1__, Long-term _A_, Individual _B or C_, Support _3 OR 2_	Investec	**£5m**	**364 days**
Banks nationalised by high credit rated (sovereign rating) countries – non UK	green	In-house/Tradition	**£5m**	**364 days**
Banks nationalised by high credit rated (sovereign rating) countries – non UK	* Short-term F1__, Long-term _A_, Individual _B or C_, Support _3 OR 2_	Investec	**£5m**	**364 days**
Money Market Funds	AAA	In-house	**£10m**	

If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate.

N.B. buy and hold may also include sale at a financial year end and repurchase the following day in order to accommodate the requirements of SORP.

Accounting treatment of investments

The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

NON-SPECIFIED INVESTMENTS: A maximum of 30% will be held in aggregate in non-specified investment

1. Maturities of ANY period

	* **Minimum Credit Criteria**	**Use**	**Max Amount £m**	**Max. maturity period**
Term deposits – local authorities	--	In-house	£5m	**5 years**
Term deposits – banks and building societies	Purple	In-house	£5m	**2 years**
Collaterised deposit	N/A	In-house	£10m	**5 years**
Commercial paper issuance covered by a specific UK Government (explicit) guarantee and issued by banks covered by the UK bank support package	UK sovereign rating or * Short-term F1, Long-term A_, Individual B/C, Support 3/2	Investec	£1m	**1 years**
Corporate Bonds issuance covered by UK Government (implicit) guarantee and issued by banks covered by the UK bank support package : ***the use of these investments would constitute capital expenditure***	UK sovereign rating or * Short-term F1, Long-term A_, Individual B/C, Support 3/2	Investec	£1m	**1 years**
Corporate Bonds other : ***the use of these investments would constitute capital expenditure***	Short-term F1, Long-term A_, Individual B/C, Support 3/2	Investec	£1m	**1 years**
Other debt issuance by UK banks covered by UK Government (explicit) guarantee	UK sovereign rating or * Short-term F1, Long-term A_, Individual B/C, Support 3/2	Investec	£1m	**1 years**
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	* Short-term F1__, Long-term _A_, Individual _B or C_, Support _3 OR 2_	Investec	£1m	**1 years**
Certificates of deposit issued by banks and building societies covered by the UK government banking support package (implicit guarantee)	Short-term F1__, Long-term _A_, Individual _B or C_, Support _3 OR 2_	Investec	£1m	**1 years**

Certificates of deposit issued by banks and building societies NOT covered by UK Government guarantee support package (implicit guarantee)	Short-term F1__, Long-term _A_, Individual _B or C_, Support _3 OR 2_	Investec	£1m	**1 years**
UK Government Gilts	UK sovereign rating	Investec	£1m	**1 years**
Local authority mortgage guarantee scheme	N/A	In-house	£5m	**5 years**

Local Authority Collateralised Deposit - Term deposits with UK institutions where such deposits are secured on loans made to other UK local authorities. These deposits will not form part of the limits determined by the individual institution's credit rating criteria. Investment is permitted subject to a maximum exposure of £10m, for a maximum term of 3 year(s).

Collaterised deposit can be structured or not – structured.

APPENDIX 1E Approved countries for investments

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

AA+
- Australia
- Belgium
- Spain *

AA
- Hong Kong
- Japan
- Kuwait
- Qatar (AA S&P rating)
- UAE

AA-
- Italy
- Portugal *
- Saudi Arabia

* Sector has suggested that clients exercise care and caution when considering placing deposits with Portuguese and Spanish banks as their economies are currently under severe pressure.

Ireland no longer appears on this list as it has been downgraded to A+.

For the purpose of the 2011/12 Strategy Cherwell District Council has decided not to place deposits with Spanish & Portuguese banks including Santander UK.

APPENDIX 1F - GLOSSARY

Asset Class Limits	Limit on the amount of the total portfolio that can be invested an asset class for example credit rated Banks, Money Market Funds unrated Building Societies
Asset Life	The length of the useful life of an asset e.g. a school
Borrowing / Investment Portfolio	A list of loans or investments held by the Council.
Borrowing Requirement	The amount that the Council needs to borrow to finance capital expenditure and manage debt.
Callable deposit	Funds placed with a financial institution without a fixed maturity date (i.e. the money can be 'called' or withdrawn at any time).
Capitalisation direction	Government approval to use capital resources to fund revenue expenditure.
Cash deposits	Funds placed with a financial institution with a fixed maturity date and interest rate.
Certificates of deposits	(CD). CDs evidence fixed maturity time deposits with issuing banks or other deposit-taking institutions. Maturities range from less than a week to five years. They are normally negotiable and enjoy a liquid secondary market. They state the (1) amount deposited, (2) rate of interest, and (3) minimum period for which the deposit should be maintained without incurring early withdrawal penalties.
CIPFA Code of Practice on Treasury Management	A code of practice issued by CIPFA detailing best practice for managing the treasury management function.
Collaterised Deposit	Term deposits with UK institutions where such deposits are secured against a collateral pool comprised of loans made to UK local authorities.
Counterparty	Banks, Building Societies and other financial institutions that the Council transacts with for borrowing and lending.
Credit Arrangements	Methods of financing such as the use of finance leases
Credit Ratings	A scoring system used by credit rating agencies such as Fitch, Moody's and Standard and Poors to indicate the creditworthiness and other factors of a Governments, banks, building societies and other financial institutions.
Creditworthiness	How highly rated an institution is according to its credit rating.
Debt Management Office	An agency of the HM Treasury and its responsibilities include debt and cash management for the UK Government
Debt Rescheduling	Refinancing loans on different terms and rates to the original loan.
Financial instrument	Document (such as a bond, share, bill of exchange, futures or options contract) that has a monetary value or evidences a legally enforceable (binding) agreement between two or more parties regarding a right to payment of money.
Fitch Ratings	A credit rating agency.
Forward commitment	Written agreement by a lender to advance a loan on a

	future date at a specified interest rate. It automatically expires if not exercised by the potential borrower.
Gilts	Also known as Gilt-edged Securities. UK central Government debt. It may be dated (redeemable) or undated. Undated gilts are perpetual debt, paying a fixed periodic coupon but having no final redemption date. Gilt yields are conventionally quoted in the UK markets on a semi-annual basis.
Interest Rate exposures	A measure of the proportion of money invested and what impact movements in the financial markets would have on them.
Lender Option Borrower Option (LOBO)	Loans that have a fixed rate for a specified number of years then can be varied by the lender at agreed intervals for the remaining life of the loan.
Limits for external debt	A Prudential Indicator prescribed by the Prudential Code sets limits on the total amount of debt the Council could afford.
Liquidity	Access to cash that is readily available.
Lowest Common Denominator	Whereby rating agencies provide credit ratings of institutions and the lowest rating is applied to determine whether they meet the criteria to be on the Council's lending list.
Maturity	The date when an investment is repaid or the period covered by a fixed term investment.
Maturity Structure of Borrowings	A profile of the Council's loan portfolio in order of the date in which they expire and require repayment.
Minimum Revenue Provision	The minimum amount, which must be charged to an authority's revenue account each year for the prudent repayment of debt.
Money Market Funds	Open ended collective investment fund that invests in highly-liquid short-term financial instruments (with maturities typically 90 days to less than one year).
Moody's	A credit rating agency.
Non Specified Investments	Investments deemed to have a greater potential of risk, such as investments for longer than one year or with institutions that do not have credit ratings, like some Building Societies. Limits must be set on the amounts that may be held in such investments at any one time during
Portfolio	A number of different assets, liabilities, or assets and liabilities together, considered as a whole. For example, a diversified investment portfolio. An investor in such a portfolio might hold a number of different investment assets within the portfolio, with the objectives of growing the total value of the portfolio and limiting the risk of losses.
Prudential Borrowing	Borrowing undertaken by the Council that does not attract government support to help meet financing costs.
Prudential Code for Capital Finance in Local Authorities	The capital finance system is based on the Prudential Code developed by CIPFA. The key feature of the system is that local authorities should determine the level of their capital investment and how much they borrow to finance that investment based on their own assessment of what

	they can afford.
Prudential Indicators	The key objectives of the Prudential Code are to ensure that the capital investment plans are affordable, sustainable and prudent. As part of this framework, the Prudential Code sets out several indicators that must be used to demonstrate this.
Public Works Loan Board (PWLB)	A central government agency which provides loans to local authorities and other prescribed institutions at interest rates slightly higher than those at which the Government itself can borrow.
Credit Rated	Institutions that possess a credit rating from a credit rating agency such as Fitch, Moody's or Standard and Poors.
Risk Control	Putting in place processes to control exposures to events.
Security	Placing cash in highly rated institutions.
Sovereign debt rating	Assessment of the international rating agencies of the likelihood that a particular country will default on its loans.
Specified Investments	Investments that offer high security and liquidity. They must have a maturity of no longer than 364 days.
Standard and Poors	A credit rating agency.
Supranational Institutions	Multi national structures - an amalgamation of different countries offering investment opportunities - for example Euro Investment Bank
UK Government Investments	Debt Management Office (DMO) deposits and bonds (gilts) for which maturity date at time of purchase is less than 365 days away
Yield	The rate of return on the current market value of an asset or liability, usually expressed as a percentage per annum. For example, today's yield to maturity of a bond measures the total return to an investor in the bond, reflecting both the interest income over the life of the bond and any capital gain (or loss) from today's market value to the redemption amount payable at maturity.