

# TAUNTON DEANE BOROUGH COUNCIL

EXECUTIVE 31 MARCH 2010

## REPORT OF THE STRATEGIC FINANCE OFFICER

(This matter is the responsibility of Councillor Henley, Leader of the Council)

### TREASURY MANAGEMENT & INVESTMENTS STRATEGY FOR 2010/2011

#### EXECUTIVE SUMMARY

- Council debt at time of issue of report £15m, outstanding investments £7.5m.
- Short-term interest rates currently at 0.5% and are forecast to rise to 0.75% in December and 1.0% by the end of the first quarter in 2011.
- Long-term rates more stable at 4.50-4.75% (50yrs) for this financial year.
- The UK is officially out of recession, but the recovery in UK growth is likely to be slow and uneven
- Interest rates at historic all time low levels. Inflation is starting to rise.
- Borrowing and debt restructuring, if undertaken, to take advantage of lower rates and match our debt to capital needs.

#### 1. PURPOSE OF REPORT

- 1.1 The purpose of this report is to present the treasury management and investment strategies for the financial year 2010/11.

#### 2. INTRODUCTION

- 2.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") requires local authorities to determine the Treasury Management Strategy Statement (TMSS). This statement includes the Investment Strategy as required under the Communities and Local Government (CLG) investment guidance.

In response to the financial crisis in 2008 and the collapse of the Icelandic banks, CIPFA revised the TM Code and Guidance Notes as well as the Prudential Indicators in late November 2009. The CLG has produced revised Investment Guidance.

- 2.2 CIPFA has defined Treasury Management as:

*"the management of the organisation'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.”*

2.3 The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Treasury management risks are identified in the Council’s approved Treasury Management Practices; the main risks to the Council’s treasury activities are:

- Liquidity Risk (Inadequate cash resources)
- Market or Interest Rate Risk (Fluctuations in interest rate levels and thereby in the value of investments).
- Inflation Risks (Exposure to inflation)
- Credit and Counterparty Risk (Security of Investments)
- Refinancing Risk (Impact of debt maturing in future years)
- Legal and Regulatory risks

2.4 The strategy also takes into account the outlook for interest rates, the Council’s current treasury position and it’s approved Prudential Indicators (attached as Appendix A). The PIs relevant to the treasury management strategy are set out below:

PI No.		2009-10 Approved	2009-10 Revised	2010-11 Estimate	2011-12 Estimate	2012-13 Estimate
6	Authorised Limit for External Debt	£40m	£40m	£40m	£40m	£40m
7	Operational Boundary for External Debt	£30m	£30m	£30m	£30m	£30m
9	Upper Limit for Fixed Interest Rate Exposure	100 %	100%	100 %	100 %	100 %
10	Upper Limit for Variable Rate Exposure	50 %	50 %	50 %	50 %	50 %
11	Upper Limit for total principal sums invested over 364 days	greater of £2m or 20%	greater of £2m or 20%	greater of £2m or 20%	greater of £2m or 20%	greater of £2m or 20%

10	Maturity structure of fixed rate borrowing	Lower Limit	Upper Limit
	:	%	%
	under 12 months	0%	50%
	12 months and within 24 months	0%	50%
	24 months and within 5 years	0%	50%
	5 years and within 10 years	0%	75%
	10 years and above	0%-	100%

### 3. THE TREASURY POSITION

3.1 The treasury position at 17/02/10 is:

	Principal £m	Average Rate %		£m	Average Rate %
<b>External borrowing:</b>					
Fixed rate – PWLB	6.000	7.96			
Variable rate – PWLB	6.000	*0.80			
Fixed rate - Market	3.000	4.25			
<b>Total external debt</b>	<b>15.000</b>	<b>4.27</b>			
<b>Total Investments</b>				7.500	1.17

\*The interest rate on the PWLB variable rate borrowing is re-set every 6 months

3.2 The estimate for interest payments in 2010/11 is £605,000 for fixed rate debt and £48,000 for variable rate debt and for interest receipts is £69,000.

### 4. OUTLOOK FOR INTEREST RATES

The economic interest rate outlook provided by the Council's treasury advisor, Arlingclose Ltd, is attached at Appendix B. It is summarised below.

- The recovery in UK growth is likely to be slow and uneven, more "W" than "V" shaped. The Bank of England will stick to its lower-for-longer stance on policy rates.
- Gilt yields will remain volatile. Yields were compressed by Quantitative Easing and will rise as the markets grapple with the wall of gilt supply in 2010 and 2011. FSA regulations forcing banks to buy gilts will initially slow this increase in yields.
- The path of base rates reflects the fragile state of the recovering economy and the severe fiscal correction that will be required post General Election which will dampen aggregate demand and cut household cashflow. Expectations of central bank exit strategies and their timing will increase volatility in sovereign bond yields and equities.
- There are significant threats to the forecast from potential downgrades to sovereign ratings and/or political instability.

Financial markets remain reasonably volatile as the structural changes necessary within economies and the banking system evolve. This volatility provides opportunities for active treasury management. The Council will reappraise its strategy from time to time and, if needs be, realign it with evolving market conditions and expectations for future interest rates.

Arlingclose's forecast for the UK Bank rate (March 2010) is:

	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
Official Bank Rate												
Upside risk		+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	0.50	0.50	0.75	1.00	1.50	2.00	2.50	2.75	3.00	3.00	3.00	3.00
Downside risk			-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50

## 5. BORROWING REQUIREMENT AND STRATEGY

5.1 The Council's underlying need to borrow for capital purposes is measured by reference to its Capital Financing Requirement (CFR) – see Appendix A. The CFR represents the cumulative capital expenditure of the local authority that has not been financed. To ensure that this expenditure will ultimately be financed, local authorities are required to make a Minimum Revenue Provision for Debt Redemption (MRP) from within the Revenue budget each year.

PI No. 3 Capital Financing Requirement	31/3/2009 Approved £m	31/3/2010 Revised £m	31/3/2011 Estimate £m	31/3/2012 Estimate £m	31/3/2013 Estimate £m
Non-HRA	8,354	8,594	9,021	9,448	9,867
HRA	14,451	14,451	14,451	14,451	14,451
<b>Total CFR</b>	<b>22,805</b>	<b>23,045</b>	<b>23,472</b>	<b>23,899</b>	<b>24,318</b>

5.2 In accordance with the Prudential Code, the Council will ensure that net external borrowing does not, except in the short term, exceed the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years.

5.3 Capital expenditure not financed from internal resources (i.e. Capital Receipts, Capital Grants and Contributions, Revenue or Reserves) will produce an increase in the CFR (the underlying need to borrow) and may in turn produce an increased requirement to charge MRP in the Revenue Account.

5.4 The Council prefers to maintain maximum control over its borrowing activities as well as flexibility on its loans portfolio. Capital expenditure levels, market conditions and interest rate levels will be monitored during the year in order to minimise borrowing costs over the medium to longer term.

5.5 A prudent and pragmatic approach to borrowing will be maintained to minimise borrowing costs without compromising the longer-term stability of the portfolio, consistent with the Council's Prudential Indicators.

5.6 In conjunction with advice from its treasury advisor, Arlingclose Ltd, the Council will keep under review the options it has in borrowing from the PWLB, the market and other sources up to the available capacity within its projected CFR and Affordable Borrowing Limit (defined by CIPFA as the Authorised Limit).

**The outlook for borrowing rates:**

- 5.7 *Fixed rate borrowing:* Short-dated gilt yields are forecast to be considerably lower than medium- and long-dated gilt yields during the financial year. Despite additional gilt issuance to fund the UK government's support to the banking industry; short-dated gilts are expected to benefit from expectations of lower interest rates as the economy struggles through a recession. Yields for these maturities will fall as expectations for lower interest rates mount.
- 5.8 *Variable Rate borrowing:* The rates for PWLB variable-rate borrowing have fallen substantially and are currently (March 2010) below 1%. They are expected to remain low as the Bank Rate is maintained at historically low levels to enable the struggling economy emerge from the recession.
- 5.9 The Council will keep under review the relative merits of a strategic exposure to variable rate debt. Decisions to borrow at low, variable rates of interest will be taken after considering the absolute level of longer term interest rate equivalents and the extent of variable rate earnings on the Council's investment balances. Should longer term rates move below the cost of variable rate borrowing any strategic exposure to variable interest rates will be reviewed and, if appropriate, reduced.
- 5.10 The Council has £3m loans which are LOBO loans (Lender's Options Borrower's Option) which are currently in their option state in FY 2010-11. In the event that the lender exercises the option to change the rate or terms of the loan, the Council will consider the terms being provided and also repayment of the loan without penalty. The Council may utilise cash resources for repayment or may consider replacing the loan(s) by borrowing from the PWLB.
- 5.11 Actual borrowing undertaken and the timing will depend on capital expenditure levels, interest rate forecasts and market conditions during the year, in order to minimise borrowing costs. The Council will be advised by Arlingclose of the specific timing of borrowing. This may include borrowing in advance of future years' requirements provided that overall borrowing is maintained within the Council's projected CFR and its approved Affordable Borrowing Limit.
- 5.12 The Council will undertake a financial options appraisal on any borrowing transactions to establish how it has arrived at its 'value for money' judgement in the use of resources.

**6. DEBT RESTRUCTURING**

- 6.1 The Council will continue to maintain a flexible policy for debt rescheduling. Market volatility may provide opportunities for rescheduling debt from time to time. The rationale for rescheduling would be one or more of the following:
- Savings in interest costs with minimal risk.
  - Balancing the volatility profile (i.e. the ratio of fixed to variable rate debt) of the debt portfolio.
  - Amending the profile of maturing debt to reduce any inherent refinancing risks.

- 6.2 In September 2009, the PWLB issued a Consultation document, entitled 'PWLB Fixed Rates', where the PWLB is reviewing the frequency of rate setting (currently daily) and could move to a live pricing basis. The deadline for the consultation period is 08/01/2010. The likely outcome of this is a reduction in the extent of the margins between premature repayment and new borrowing rates, particularly for longer maturities.
- 6.3 Any rescheduling activity will be undertaken within the Council's treasury management policy and strategy. The Council will agree in advance with Arlingclose the strategy and framework within which debt will be repaid/rescheduled if opportunities arise. Thereafter the Council's debt portfolio will be monitored against equivalent interest rates and available refinancing options on a regular basis. As opportunities arise, they will be identified by Arlingclose and discussed with the Council's officers.
- 6.4 All rescheduling activity will comply with the accounting requirements of the local authority SORP and regulatory requirements of the Capital Finance and Accounting Regulations (SI 2007 No 573 as amended by SI 2008/414).

## **7. INVESTMENT POLICY AND STRATEGY**

- 7.1 Guidance from the CLG on Local Government Investments in England requires that an Annual Investment Strategy (AIS) be set.

### **Investment Policy**

- 7.2 The Council's general policy objective is to invest its surplus funds prudently. The Council's investment priorities are:
- security of the invested capital;
  - liquidity of the invested capital;
  - an optimum yield which is commensurate with security and liquidity.

The speculative procedure of borrowing purely in order to invest is unlawful.

- 7.3 Investments are categorised as 'Specified' or 'Non Specified' investments based on the criteria in the CLG Guidance. Potential instruments for the Council's use within its investment strategy are contained in Appendix C.
- 7.4 The credit crisis has refocused attention on the treasury management priority of security of capital monies invested. The draft revisions to the CLG's Investment Guidance state that a specified investment is one made with a body or scheme of "high credit quality". The Council will continue to maintain a counterparty list based on these criteria and will monitor and update the credit standing of the institutions on a regular basis. This assessment will include credit ratings and other alternative assessments of credit strength as outlined in paragraph 7.10. The CLG's Draft revisions to its Guidance on local government investments recommend that the Investment Strategy should set out the procedures for determining the maximum periods for which funds may

prudently be committed. Such decisions will be based on an assessment of the authority's Balance Sheet position with the limit being set in Prudential Indicator 12 - Upper Limit for total principal sums invested over 364 days.

- 7.5 The Council's estimated levels of investments are set out in 3.1 of this Treasury Management Strategy Statement.

Borrowing and debt rescheduling activity will be reported to the Executive meeting twice annually.

### **Investment Strategy**

- 7.6 The global financial market storm in 2008 and 2009 has forced investors of public money to reappraise the question of risk versus yield. Income from investments is no longer a key support in the Council's budget.
- 7.7 **It is expected that the Bank Rate will remain at 0.5 % until December 2010 when an increase to 0.75% is forecast followed by a further increase to 1.0% in March 2011. Short-term money market rates will continue to fall to very low levels which will have a significant impact on investment income.** The Council's strategy must however be geared towards this development whilst adhering to the principal objective of security of invested monies.
- 7.8 The S151 Officer under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on the core investment portfolio will be reported to the Executive meeting twice annually.

### **Investments managed in-house:**

- 7.9 The Council's shorter term cashflow investments are made with reference to the outlook for the UK Bank Rate and money market rates. For these monies, the Council will mainly invest in
- The Debt Management Agency Deposit Facility (The rates of interest from the DMADF are below equivalent money market rates. However, the returns are an acceptable trade-off for the guarantee that the Council's capital is secure.)
  - AAA-rated Money Market Funds with a Constant Net Asset Value (Constant NAV) investing predominantly in government securities and financial institutions
  - Deposits with other local authorities
  - Business reserve accounts and Term Deposits. These have been primarily restricted to UK Institutions that are rated at least A+ long term (or equivalent), and have access to the UK Government's 2008 Credit Guarantee Scheme (CGS) (only existing guaranteed debt after 28/02/2010)
  - Gilts
  - Bonds issued by Multilateral Development Banks

- Certificates of deposit.

7.10 Conditions in the financial sector have begun to show signs of improvement, albeit with substantial intervention by government authorities. In order to diversify the counterparty list, the use of comparable non-UK Banks for investments is now considered appropriate.

The sovereign states whose banks are to be included are Australia, Canada, Finland, France, Germany, Netherlands, Spain, Switzerland and the US. These countries and the Banks within them have been selected after analysis and careful monitoring of:

- Credit Ratings (minimum long-term A+)
- Credit Default Swaps
- GDP; Net Debt as a Percentage of GDP
- Sovereign Support Mechanisms / potential support from a well-resourced parent institution
- Share Price

The Council has also taken into account information on corporate developments and market sentiment towards the counterparties. The Council and its Treasury Advisors, Arlingclose, will continue to analyse and monitor these indicators and credit developments on a regular basis and respond as necessary to ensure security of the capital sums invested.

We do remain in a heightened state of sensitivity to risk. Vigilance is key. This modest expansion of the counterparty list is an incremental step. In order to meet requirements of the revised CIPFA Treasury Management Code, the Council is focusing on a range of indicators (as stated above), not just credit ratings.

Limits for Specified Investments are set out in Appendix C

7.11 Protection against the downward move in interest rates through 1-year deposits and through longer-term secure investments will be actively considered within the limits the Council has set for Non-Specified Investments and may include:

- **Supranational bonds (bonds issued by multilateral development banks):** The joint and individual pan European government guarantees in place on these bonds provide security of the principal invested. Even at the lower yields likely to be in force, the return on these bonds will provide certainty of income against an outlook of low official interest rates.
- **UK government guaranteed bonds and debt instruments issued by banks/building societies:** The UK Government's 2008 Credit Guarantee Scheme permits specific UK institutions to issue of short-dated bonds with an explicit government guarantee. The bonds are issued at a margin over the underlying gilt and would be a secure longer-term investment option. (These bonds would, under existing statute, be capital expenditure investments.)



## **8. OTHER ISSUES**

### **8.1 Project Taunton**

The treasury management and investment strategies, outlined above, have assumed the largely neutral impact of Project Taunton, as per all option appraisals undertaken to date. However, projects of this scale can have both a positive or negative impact on the timing of capital expenditure and thus cash flow. As the project stages are developed and approved any impact on the Treasury function will be assessed and strategies may have to be altered. Any impact on strategy will be reviewed as options are considered and reported to members throughout.

### **8.2. Reporting on the Treasury Outturn**

The Strategic Finance Officer will report to the Executive on treasury management activity / performance as follows:

(a) Every six months against the strategy approved for the year.

(b) The Council will produce an outturn report on its treasury activity no later than 30<sup>th</sup> September after the financial year end.

(c) Corporate Governance Committee will be responsible for the scrutiny of treasury management activity and practices.

### **8.3 Training**

The day to day operational Treasury Management activity of the Council is managed by South West One under a contract. The Council's Section 151 Officer meets regularly with the contractor to review operational issues which include the provision of suitably qualified/trained staff for the treasury management activity.

The strategic treasury management activity is carried out by the Council's Section 151 Officer assisted by external treasury advisors.

The training requirements of members are identified annually and fed into a corporate member development programme. The need for treasury management member training is reviewed by the Council's Section 151 Officer.

### **8.4 Investment Consultants**

The Council has appointed Arlingclose as its Treasury Advisor for information, advice or assistance relating to investments and borrowing. There are regular quarterly meetings at which performance is reviewed and the quality of service monitored. The meeting is chaired by the Council's Section 151 Officer.

### **8.5 Publication**

The approved Treasury Management and Investment Strategy is made available to the public free of charge via the Council's website.

## **9. IMPACT ON CORPORATE PRIORITIES**

- 9.1 Treasury Management supports the entire range of services within the Council and thus has an impact on all Corporate Priorities.

## **10. RECOMMENDATIONS**

- 10.1 The Executive are requested to approve the proposed Treasury Management Strategies outlined in this report.

### **Background Papers**

Executive 02/12/09 – Treasury Management Update 2009/10 & 2010/11.

Executive 10/02/10 – General Fund Revenue Estimates 2010/11

**Contact Officer:** Maggie Hammond,  
Strategic Finance Officer,  
Tel: (01823) 358698 or Ext 2712  
E-mail: [m.hammond@tauntondeane.gov.uk](mailto:m.hammond@tauntondeane.gov.uk)

**Appendix A**

PRUDENTIAL INDICATOR	2008/09 £'000	2009/10 £'000	2010/11 £'000	2011/12 £'000	2012/13 £'000
	outturn	estimate	estimate	estimate	estimate
<b>Capital Expenditure</b>					
General Fund	£8,506	£3,088	£2,852	£2,528	£1,785
HRA	£5,428	£6,724	£4,560	£4,300	£4,399
<b>TOTAL</b>	<b>£13,934</b>	<b>£9,812</b>	<b>£7,412</b>	<b>£6,828</b>	<b>£6,184</b>
<b>Ratio of financing costs to net revenue stream</b>					
General Fund	-3.28%	1.08%	1.07%	1.13%	1.15%
HRA	2.57%	1.83%	1.82%	1.47%	1.24%
<b>Net borrowing projection</b>					
brought forward 1 April	£9,425	£9,900	£10,520	£11,910	£13,274
Carried forward 31 March	£9,900	£10,520	£11,910	£13,274	£13,894
in year borrowing requirement	£475	£620	£1,390	£1,364	£620
<b>Capital Financing Requirement as at 31 March</b>					
General Fund	£8,354	£8,594	£9,021	£9,448	£9,867
HRA	£14,451	£14,451	£14,451	£14,451	£14,451
<b>TOTAL</b>	<b>£22,805</b>	<b>£23,045</b>	<b>£23,472</b>	<b>£23,899</b>	<b>£24,318</b>
<b>Incremental impact of capital investment decisions</b>	<b>£ p</b>	<b>£ p</b>	<b>£ p</b>	<b>£ p</b>	<b>£ p</b>
Increase in council tax (band D)	0.65	0.86	0.83	0.15	0.03
<b>Authorised limit for external debt -</b>					
<b>TOTAL</b>	<b>£40,000,000</b>	<b>£40,000,000</b>	<b>£40,000,000</b>	<b>£40,000,000</b>	<b>£40,000,000</b>
<b>Operational boundary for external debt -</b>					
<b>TOTAL</b>	<b>£30,000,000</b>	<b>£30,000,000</b>	<b>£30,000,000</b>	<b>£30,000,000</b>	<b>£30,000,000</b>
<b>Upper limit for fixed interest rate exposure</b>					
Net interest re fixed rate borrowing/ investments	100%	100%	100%	100%	100%
<b>Upper limit for variable rate exposure</b>					
Net interest re variable rate borrowing/ investments	50%	50%	50%	50%	50%
<b>Maturity Structure of Fixed Rate Borrowing</b> (Upper and lower limits)					
under 12 months	0% to 50%	0% to 50%	0% to 50%	0% to 50%	0% to 50%
12 months and within 24 months	0% to 50%	0% to 50%	0% to 50%	0% to 50%	0% to 50%
24 months and within 5 years	0% to 50%	0% to 50%	0% to 50%	0% to 50%	0% to 50%
5 years and within 10 years	0% to 50%	0% to 50%	0% to 75%	0% to 75%	0% to 75%
10 years and above	0% to 100%	0% to 100%	0% to 100%	0% to 100%	0% to 100%
<b>Upper limit for total principal sums invested for over 364 days</b> (per maturity date)					
	Greater of £2m or 20%	Greater of £2m or 20%	Greater of £2m or 20%	Greater of £2m or 20%	Greater of £2m or 20%

## Arlingclose's Forecast for Interest Rates (March 2010)

	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
<b>Official Bank Rate</b>												
Upside risk		+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	0.50	0.50	0.75	1.00	1.50	2.00	2.50	2.75	3.00	3.00	3.00	3.00
Downside risk			-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
<b>1-yr LIBID</b>												
Upside risk		+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	1.25	1.50	1.75	2.25	3.00	3.50	4.00	4.00	4.00	4.00	4.00	4.00
Downside risk			-0.25	-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
<b>5-yr gilt</b>												
Upside risk	+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	2.80	2.90	3.00	3.25	3.50	3.75	4.00	4.25	4.25	4.25	4.25	4.25
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
<b>10-yr gilt</b>												
Upside risk	+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.50	+0.50	+0.50	+0.50
Central case	4.00	4.00	4.00	4.25	4.25	4.50	4.50	4.75	5.00	5.00	5.00	5.00
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
<b>20-yr gilt</b>												
Upside risk	+0.50	+0.50	+0.50	+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.50	+0.50	+0.50
Central case	4.60	4.75	4.75	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
<b>50-yr gilt</b>												
Upside risk	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	4.50	4.50	4.50	4.75	4.75	4.75	4.75	4.75	5.00	5.00	4.75	4.75
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25

- The recovery in UK growth is likely to be slow and uneven, more “W” than “V” shaped. The Bank of England will stick to its lower-for-longer stance on policy rates.
- Gilt yields will remain volatile. Yields were compressed by Quantitative Easing and will rise as the markets grapple with the wall of gilt supply in 2010 and 2011. FSA regulations forcing banks to buy gilts will initially slow this increase in yields.
- The path of base rates reflects the fragile state of the recovering economy and the severe fiscal correction that will be required post General Election which will dampen aggregate demand and cut household cashflow. Expectations of central bank exit strategies and their timing will increase volatility in sovereign bond yields and equities.
- There are significant threats to the forecast from potential downgrades to sovereign ratings and/or political instability.

Underlying assumptions:

- The Bank of England paused its Quantitative Easing (QE) program in January having purchased £200bn of assets to insure against the downside risks to growth. We estimate that QE has depressed gilt yields by around 70bps (0.7%).
- The Bank's February Inflation Report forecasts a slow recovery with an uncertain outlook for corporate and consumer spending. UK growth (GDP) rose by a revised 0.3% in Q4 2009, much of this impetus from government spending. Q1 growth is looking fragile.
- Looming bank regulation, including liquidity and capital requirements, will curb bank lending activity. The Bank retains the option to reduce the rate on commercial banks' deposits to encourage them to lend. But FSA regulations will force banks to buy more Gilts which could help slow the rise in yields in 2010/11, a QE by proxy.

- The employment outlook remains uncertain. Pay freezes, short hours, job cuts and a migration toward part time employment will continue into 2010 keeping the headline unemployment number down, but aggregate earnings too.
- Recent increases in the savings ratio, reduction in net consumer credit and weak consumer confidence are consistent with a lower future trend rate of growth.
- Commodity prices and VAT reverting to 17.5% have pushed inflation to 3.5%, prompting a letter from the Bank's Governor to the Chancellor. We believe that inflation will rise further, before moderating in the second half of the year.
- The UK fiscal deficit remains acute. Cuts in public spending and tax increases are now inevitable and a credible plan to reduce the deficit is urgently required, the absence of which increases the potential of a sovereign downgrade. The likelihood of a hung parliament has grown and this has and will be disruptive to financial markets.
- All this at a time when the markets are being asked to absorb unprecedented levels of government debt.
- The US Federal Reserve will maintain rates at low levels but begin to withdraw the additional liquidity and stimulus provided during the financial crisis.
- One benefit of the current weakness of Sterling may be that the UK's export economy might enjoy a boost, however our trading partners are also suffering low demand.

### Specified and Non Specified Investments

#### **Specified Investments identified for use by the Council**

Specified Investments will be those that meet the criteria in the CLG Guidance, i.e. the investment

- is sterling denominated
- has a maximum maturity of 1 year
- meets the “high credit quality” as determined by the Council or is made with the UK government or is made with a local authority in England, Wales, Scotland or Northern Ireland or a parish or community council.
- the making of which is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate).

“Specified” Investments identified for the Council’s use are:

- Deposits in the DMO’s Debt Management Account Deposit Facility
- Deposits with UK local authorities
- Deposits with banks and building societies
- \*Certificates of deposit with banks and building societies
- \*Gilts : (bonds issued by the UK government)
- \*Bonds issued by multilateral development banks
- AAA-rated Money Market Funds with a Constant Net Asset Value (Constant NAV)
- Other Money Market Funds and Collective Investment Schemes– i.e. credit rated funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573 and subsequent amendments.

1. *\* Investments in these instruments will be on advice from the Council’s treasury advisor.*
2. *The use of the above instruments by the Council’s fund manager(s) will be by reference to the fund guidelines contained in the agreement between the Council and the individual manager.*

For credit rated counterparties, the minimum criteria will be the short-term/long-term ratings assigned by various agencies which may include Moody’s Investors Services, Standard & Poor’s, Fitch Ratings:

Long-term minimum: A1 (Moody’s) or A+ (S&P) or A+(Fitch)

Short-term minimum: P-1 (Moody’s) or A-1 (S&P) or F1 (Fitch).

The Council will also take into account information on corporate developments of and market sentiment towards investment counterparties.

	<u>Credit Criteria</u>	<u>Maximum Maturity</u>
<b><u>Specified Investments</u></b>		
Debt Management Account Deposit Facility (DMADF)	Not applicable	1 year
Term Deposits – Local Authorities	Not applicable	1 year
Term Deposits – Banks and Building Societies	A+ Long Term, F1 Short Term or equivalent	1 year
Callable Deposits – Banks and Building Societies	A+ Long Term, F1 Short Term or equivalent	1 year
Money Market Funds	AAA only	Not applicable, instant access available to all of deposit
<b><u>Non Specified Investments</u></b>		
Term Deposits – Local Authorities	Not applicable	2 years
Term Deposits – Banks and Building Societies	AA- Long Term, F1+ Short Term or equivalent	2 years
Gilts	AAA	5 years, including the 5-year benchmark gilt
Bonds issued by multilateral development banks	AAA	5 years
Bonds issued by banks where the bond is guaranteed by the UK government (such an investment will be a capital expenditure investment)	AAA	5 years

NB – all investments are limited to a maximum amount of, the lesser of £2m or 20%, of investment portfolio, per Counterparty. The exception to this being investments made with the Debt Management Account Deposit Facility.