REPORT TO:	**FINANCE AND MANAGEMENT COMMITTEE**	**AGENDA ITEM: 12**
DATE OF MEETING:	**17th FEBRUARY 2009**	**CATEGORY: RECOMMENDED**
REPORT FROM:	**DIRECTOR OF CORPORATE SERVICES**	**OPEN**
MEMBERS' CONTACT POINT:	**KEVIN STACKHOUSE (595811)**	**DOC:**
SUBJECT:	**TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL INDICATORS 2009/10 to 2011/12**	**REF:** u/ks/treasury management/strategies/200910
WARD(S) AFFECTED:	**ALL**	**TERMS OF REFERENCE: FM 08**

1.0 Recommendations

1.1 That the Prudential Indicators and Limits for 2009/10 to 2011/12 contained within the report be recommended for approval by Full Council on 26th February 2009.

1.2 That the Treasury Management Strategy for 2009/10 is considered and approved.

1.3 That the Investment Strategy for 2009/10 including the associated lending list and policy is considered and approved.

2.0 Purpose of the Report

2.1 This report outlines the Council's Prudential Indicators for 2009/10 to 2011/12 and sets out the expected treasury operations for this period. It fulfils three key reports required by the Local Government Act 2003.

- The CIPFA Prudential Code requires the reporting of the Indicators for Capital Finance in Local Authorities.

- The Treasury Strategy in accordance with the CIPFA Code of Practice on Treasury Management.

- The Investment Strategy in accordance with the Department of Communities and Local Government investment guidance.

3.0 Executive Summary

The Prudential System for Capital Finance

3.1 The main aims of the national prudential system are to ensure that:

- Capital investment plans of local authorities are affordable and sustainable.
- Treasury management decisions are taken in accordance with best professional practice.
- Financial planning and asset management are integrated into the Council's overall corporate planning arrangements.

3.2 This is measured within a set of prudential indicators. The main purpose of these indicators is to provide the limits and benchmarks to control the level of capital expenditure, borrowing and investment. The Council is expected to operate well within these limits, in particular when borrowing and investing.

3.3 The relevant indicators required under the regulations are summarised in the following tables.

3.4 Firstly, the estimated capital expenditure (as set out in the approved capital investment programme) is detailed in Table 1 below:

Table 1 – Capital Expenditure (Capital expenditure is shown in more detail in Table 6)				
	2008/09 Revised £000	**2009/10 Estimated £000**	**2010/11 Estimated £000**	**2011/12 Estimated £000**
General Fund	3,427	1,633	684	472
HRA	2,978	2,462	2,320	2,440
Total	**6,405**	**4,095**	**3,004**	**2,912**

3.5 The capital expenditure programme will be financed directly from government grants, external contributions, council reserves and capital receipts. Where direct financing does not cover the planned expenditure, the residue effectively becomes the Council's external borrowing requirement, which is termed the Capital Financing Requirement (CFR).

3.6 The CFR is a measure of the Council's underlying need to borrow for capital investment and is based on the value of its assets contained in its Balance Sheet. It does not necessarily represent the amount of debt outstanding.

3.7 The General Fund CFR is reduced each year by a statutory revenue charge, but there is no similar requirement for the Housing Revenue Account. The expected CFR is detailed in Table 2 below:

Table 2 – Capital Financing Requirement (CFR calculation is shown in more detail in Table 7)				
	2008/09 Revised £000	2009/10 Estimated £000	2010/11 Estimated £000	2011/12 Estimated £000
General Fund	7,435	7,138	6,852	6,578
HRA	5,495	5,477	5,459	5,441
Total	**12,930**	**12,615**	**12,311**	**12,019**

3.8 In addition to the CFR the Council's expected external debt position for each year (the Operational Boundary) and the maximum amount that could be borrowed (the Authorised Limit) are detailed in Table 3 below.

Table 3 – Operational Boundary and Authorised Limit (These calculations are shown in more detail in Table 10)				
	2008/09 Revised £000	2009/10 Estimated £000	2010/11 Estimated £000	2011/12 Estimated £000
Authorised Limit	24,550	25,287	26,046	26,827
Operational Boundary	12,950	12,650	12,350	12,050

3.9 The estimated cost of financing the capital programme contained in the consolidated budget proposals on council tax and housing rents are summarised in Table 4 below.

Table 4 – Incremental impact of capital investment decisions (These calculations are shown in more detail in Tables 11, 12 and 13)				
	2008/09 Revised £	2009/10 Estimated £	2010/11 Estimated £	2011/12 Estimated £
Band D Council Tax	19.82	11.19	9.63	8.58
Housing rent levels	54.00	47.28	37.19	26.95

3.10 The resources applied to finance the capital programme are one of the elements that influence the overall resources of the Council. The expected position of the Council's year-end resources (balances, capital receipts and contributions) is supplemented with the expected cash flow position to provide an overall estimate of the year-end investment position.

3.11 Table 5 below details the estimated investment position at the year-end.

Table 5 – Investments (These calculations are shown in more detail in Tables 8)				
	2008/09 Revised £000	2009/10 Estimated £000	2010/11 Estimated £000	2011/12 Estimated £000
Total resources	10,106	5,025	3,799	3,444
Working capital	3	3	3	3
Total Resources Available to Invest	**10,109**	**5,028**	**3,802**	**3,447**
Total investments at year-end including the estimated effects of the Council's cash flow position				
Principal sums invested < 364 days	500	400	375	350
Sums invested >364 days	0	0	0	0

4.0 <u>Detail</u>

Prudential Indicators 2009/10 – 2011/12

4.1 The Local Government Act 2003 requires the Council to adopt the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code and in doing so to calculate and monitor a set of prudential indicators.

4.2 This report revises the indicators for 2008/09, 2009/10 and 2010/11 and introduces new indicators for 2011/12. Each indicator either summarises the expected treasury activity or introduces limits upon the activity and reflects the outcome of the Council's underlying capital appraisal systems.

4.3 Within this overall prudential framework there is a clear impact on the Council's treasury management activity, either through borrowing or investment activity.

4.4 As a consequence, the Treasury Management Strategy for 2009/10 is included (**Appendix 2**) to complement the indicators and this report includes the prudential indicators relating to the treasury activity.

Capital Expenditure

4.5 The Council's capital expenditure plans are the first of the prudential indicators.

4.6 Resources such as capital receipts and external contributions can pay for this expenditure immediately. However, if resources are insufficient any residual expenditure will effectively create a borrowing need.

4.7 A more detailed analysis from which the figures in this report are drawn, breaking down the General Fund and Housing Revenue Account (HRA) split, are contained in **Appendix 1.**

4.8 A certain level of capital expenditure will be grant supported by the Government, anything above this level will be unsupported and will need to be paid for from the Council's own resources or from other contributions.

4.9 The Government retains an option to control either the total of all Council's plans, or those of a specific council, although no control has yet been required.

4.10 A summary of the capital expenditure and financing estimates are detailed in Table 6 below. It shows that by having a net financing need of zero, that the Council has no plans to undertake any new borrowing to 2012.

Table 6 – Capital Expenditure and Financing				
	2008/09 Revised £000	**2009/10 Estimated £000**	**2010/11 Estimated £000**	**2011/12 Estimated £000**
Capital Expenditure				
General Fund	3,427	1,633	684	472
HRA	2,978	2,462	2,320	2,440
Total Capital Expenditure	**6,405**	**4,095**	**3,004**	**2,912**
Financed by:				
Capital receipts (see note)	1,724	1,191	754	763
Capital grants	3,997	2,679	2,250	2,149
Capital reserves	634	225	0	0
Revenue Contributions	50	0	0	0
Net Financing Need for the Year	**0**	**0**	**0**	**0**

Note – the capital receipts for 2010 to 2012 have yet to be identified. However, provision has been made in the General Fund Revenue Account to meet the shortfall should the receipts not be generated.

The Council's Borrowing Need (Capital Financing Requirement)

4.11 The second Prudential Indicator is the Capital Financing Requirement (CFR). The CFR is a measure of the Council's underlying need to borrow for capital investment and is based on the value of its assets contained in the Balance Sheet.

4.12 The capital expenditure that has not been immediately paid for will increase the CFR through additional borrowing. A more detailed analysis from which the figures in this report are drawn, breaking down the General Fund and HRA split are contained in **Appendix 1.**

4.13 The Council is required to pay off an element of the accumulated General Fund CFR each year through a revenue charge called the Minimum Revenue Provision (MRP). The Council is also allowed to undertake additional voluntary payments (VRP).

4.14 A summary of the CFR estimates are detailed Table 7 below:

Table 7 – Capital Financing Requirement (CFR)				
	2008/09 Revised £000	**2009/10 Estimated £000**	**2010/11 Estimated £000**	**2011/12 Estimated £000**
Movement in CFR represented by:				
Net financing need for the year	0	0	0	0
MRP/VRP and other financing movements	(328)	(315)	(304)	(292)
Movement in CFR	**(328)**	**(315)**	**(304)**	**(292)**
Capital Financing Requirement				
CFR – General Fund	7,435	7,138	6,852	6,578
CFR – Housing	5,495	5,477	5,459	5,441
Total CFR	**12,930**	**12,615**	**12,311**	**12,019**
Movement in CFR	**(328)**	**(315)**	**(304)**	**(292)**

The Use of the Council's Resources and the Investment Provision

4.15 The application of resources (capital receipts, reserves and contributions) 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 (assets sales, etc).

4.16 Table 8 below details the estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

Table 8 – Investments				
Year-end Resources	**2008/09 Revised £000**	**2009/10 Estimated £000**	**2010/11 Estimated £000**	**2011/12 Estimated £000**
Fund Balances and Reserves	5,702	5,894	5,796	4,788
Capital Receipts, Grants and Contributions	1,810	668	0	0
Total Core Funds	**7,512**	**6,562**	**5,796**	**4,788**
Working Capital *	3	4	4	4
Expected Investments (taking into account expected year-end cash flow position)	**500**	**400**	**375**	**350**

*** Working capital balances shown are estimated year-end these may be higher mid year.**

Limits to Borrowing Activity

4.17 Within the Prudential Indicators there are a number of key indicators to ensure that the Council operates its borrowing within defined limits.

4.18 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 2009/10 and the next two financial years.

4.19 This allows some flexibility if a limited amount of borrowing was required to meet temporary shortfalls in cash to pay suppliers, etc. The Council's estimated position is detailed in Table 9 below:

Table 9 – Limits to Borrowing Activity				
	2008/09 Revised £000	**2009/10 Estimated £000**	**2010/11 Estimated £000**	**2011/12 Estimated £000**
Gross Borrowing	1,274	1,274	1,274	1,274
Less Investments	(550)	(400)	(375)	(350)
Net Borrowing	725	874	899	924
CFR	12,930	12,615	12,311	12,019

Note - Gross borrowing represents one outstanding money market loan and money held on deposit on behalf of Parish Councils.

4.20 The above table shows that as net borrowing is below the CFR, the Council has complied with this Prudential Indicator in the current year and does not envisage difficulties for the future. The Council's overall financial plans do not at this stage rely on any new borrowing and it is expected that the Council will continue to be a net lender of funds over this period.

4.21 A further two Prudential Indicators that control or anticipate the overall level of borrowing are detailed below.

The Authorised Limit for External Debt

4.22 This represents a limit beyond which external debt is prohibited and this limit needs to be set or revised. It reflects the level of external debt, which while not desired, could be afforded in the short term, but is not sustainable in the longer term.

4.23 It represents a temporary financing limit should the Council need to borrow on a temporary basis to meet major shortfalls in cash income.

4.24 It is also the statutory limit determined under section 3(1) of the Local Government Act 2003.

The Operational Boundary for External Debt

4.25 This indicator is based on the expected maximum external debt (as described above) during the course of the year, but it is not a limit.

4.26 It is designed to help the Head of Finance manage treasury activity on a daily basis and acts as an early warning sign of any potential issues.

4.27 The Authorised Limit and Operational Boundary are detailed in Table 10 below:

Table 10 – Authorised Limit and Operational Boundary				
Authorised Limit	**2008/09 Revised £000**	**2009/10 Estimated £000**	**2010/11 Estimated £000**	**2011/12 Estimated £000**
Borrowing	22,813	24,099	25,277	26,550
Other Long Term Liabilities	1,737	1,188	769	277
Total	**24,550**	**25,287**	**26,046**	**26,827**
Operational Boundary	**2008/09 Revised £000**	**2009/10 Estimated £000**	**2010/11 Estimated £000**	**2011/12 Estimated £000**
Borrowing	11,213	11,462	11,581	11,773
Other Long Term Liabilities	1,737	1,188	769	277
Total	**12,950**	**12,650**	**12,350**	**12,050**

Affordability Prudential Indicators

4.28 The previous section covers the overall capital and control of borrowing. However, within this framework, Prudential Indicators are required to assess the affordability of capital investment plans.

4.29 These provide an indication of the impact of the capital investment plans on the Council's overall finances.

4.30 **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 liabilities, net of investment income) against the net revenue stream. This Prudential Indicator is detailed in Table 11 below:

Table 11 – Estimates of the Ratio of Financing Costs to Net Revenue Stream				
Revenue Account	**2008/09 Revised**	**2009/10 Estimated**	**2010/11 Estimated**	**2011/12 Estimated**
General Fund	5.9%	3.6%	3.1%	2.8%
HRA	3.6%	2.9%	2.2%	1.6%

4.31 The estimates of financing costs include current borrowing commitments. Low percentages and/or reducing amounts are considered to be a positive sign that the Council is not relying heavily on loan financing to deliver its services.

4.32 **Estimates of the incremental impact of capital investment decisions on the Council Tax** – this indicator identifies the trend in how much per year the costs of borrowing and other interest payments, both historic and planned, cost each household (at Band D council tax rate) in the District. This is shown in Table 12 below.

Table 12 – Incremental Impact of Capital Investment				
Cost per household per year	**2008/09 Revised £**	**2009/10 Estimated £**	**2010/11 Estimated £**	**2011/12 Estimated £**
Council Tax Band D	19.82	11.19	9.63	8.58

4.33 The reducing cost reflects lower interest payments in future years as the remaining Covenant loan financing is repaid.

4.34 **Estimates of the incremental impact of capital investment decisions on Housing Rent levels** – Similar to Council Tax, this indicator identifies the trend in how much per year the costs of borrowing and other interest payments, both historic and planned, cost each council house tenant. This is shown in Table 13 below.

Table 13 – Incremental Impact of Capital Investment				
Cost per council house tenant per year	**2008/09 Revised £**	**2009/10 Estimated £**	**2010/11 Estimated £**	**2011/12 Estimated £**
Housing Rent Level	54.00	47.28	37.19	26.95

5.0 Financial Implications

5.1 As detailed in the report.

6.0 Corporate Implications

6.1. None

7.0 Community Implications

7.1 None

8.0 Background Papers

8.1 Local Government Act 2003 (Part 1)

Appendix 1

£000s	2008/09 Revised Estimate	2009/10 Estimated	2010/11 Estimated	2011/12 Estimated
CAPITAL EXPENDITURE AND THE SOURCES OF FINANCE				
Capital Expenditure – General Fund				
Supported spend	3,427	1,633	684	472
Unsupported spend	0	0	0	0
Total spend	3,427	1,633	684	472
Financed by:				
Capital receipts	1,204	885	423	372
Capital grants	2,122	748	261	100
Capital reserves	101	0	0	0
Revenue	0	0	0	0
Total financing	3,427	1,633	684	472
Net financing need	0	0	0	0
Capital Expenditure – Housing Revenue Account				
Supported spend	2,978	2,462	2,320	2,440
Unsupported spend	0	0	0	0
Total spend	2,978	2,462	2,320	2,440
Financed by:				
Capital receipts	520	306	331	391
Capital grants	1,875	1,931	1,989	2,049
Capital reserves	533	225	0	0
Revenue	50	0	0	0
Total financing	2,978	2,462	2,320	2,440
Net financing need	0	0	0	0
Capital Expenditure – Total				
Supported spend	6,405	4,095	3,004	2,912
Unsupported spend	0	0	0	0
Total spend	6,405	4,045	3,004	2,912
Financed by:				
Capital receipts	1,724	1,191	754	763
Capital grants	3,997	2,679	2,250	2,149
Capital reserves	634	225	0	0
Revenue	50	0	0	0
Total financing	6,405	4,095	3,004	2,912
Net financing need	0	0	0	0

£000s	2008/09 Proposed Outturn	2009/10 Estimated	2010/11 Estimated	2011/12 Estimated
THE CAPITAL FINANCING REQUIREMENT				
The Capital Financing Requirement - General Fund				
Opening Balance	7,745	7,435	7,138	6,852
Net financing need	0	0	0	0
Less MRP & VRP	-310	-297	-286	-274
Less other financing movements	0	0	0	0
CFR Closing balance	7,435	7,138	6,852	6,578
Net movement in CFR	-310	-297	-286	-274
The Capital Financing Requirement - HRA				
Opening Balance	5,513	5,495	5,477	5,459
Net financing need	0	0	0	0
Voluntary RP	0	0	0	0
Less other financing movements	-18	-18	-18	-18
CFR Closing balance	5,495	5,477	5,459	5,441
Net movement in CFR	-18	-18	-18	-18
The Capital Financing Requirement - Total				
Opening Balance	13,258	12,930	12,615	12,311
Net financing need	0	0	0	0
MRP & VRP	-310	-297	-286	-274
Less other financing movements	-18	-18	-18	-18
CFR Closing balance	12,930	12,615	12,311	12,019
Net movement in CFR	-328	-315	-304	-292

*VRP - Voluntary revenue

EXTERNAL DEBT & OTHER LONG TERM LIABILITIES				
Opening Balance 1 April	1,000	1,000	1,000	1,000
Maturing Debt	0	0	0	0
Borrowing - Maturing Debt	0	0	0	0
Borrowing - Change in CFR	0	0	0	0
Total Debt 31 March	1,000	1,000	1,000	1,000
Net movement in debt	0	0	0	0
Other long term liabilities	1,737	1,188	769	277

AUTHORISED LIMIT AND OPERATIONAL BOUNDARY				
Authorised Limit	24,550	25,287	26,046	26,827
Operational Boundary	12,950	12,650	12,350	12,050
INVESTMENTS				
Opening Balance 1 April	3,660	500	400	375
Cash flow movements	2,541	4,981	1,181	350
Movement in reserves /balances	-5,701	-5,081	-1,206	-375
Total Investments 31 March	500	400	375	350
Net movement in investments	-3,160	-100	-25	-25

Appendix 2

South Derbyshire
District Council

Treasury Management and Investment Strategy 2009/10 – 2011/12

February 2009

Treasury Management and Investment Strategy 2008/09 – 2010/11

Contents

1.0 Introduction

1.1 The treasury management service is an important part of the overall financial management of the Council's affairs. The prudential indicators in the main report consider the affordability and impact of capital expenditure decisions, and set out the Council's overall capital investment framework.

1.2 The treasury service considers the effective funding of these decisions. Together they form part of the process that ensures the Council achieves a balanced budget requirement under the Local Government Finance Act 1992. There are specific treasury prudential indicators included in this strategy, which require approval.

1.3 The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management).

1.4 The Council has adopted the Code and as a result, has adopted a Treasury Management Policy Statement. An updated policy statement was approved on 17th February 2009. This adoption meets the requirements of the first of the treasury prudential indicators.

1.5 The Policy requires an annual strategy to be reported, outlining the expected treasury activity for the forthcoming 3 years.

1.6 A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. A further treasury report is produced after the year-end to report on actual activity for the year.

1.7 This strategy covers:

- The Council's debt and investment projections.
- The expected movement in interest rates.
- The Council's borrowing and investment strategies.
- Treasury performance indicators.
- Specific limits on treasury activities.
- Any local treasury issues.

2.0 Debt and Investment Projections 2009/10 to 2011/12

2.1 The borrowing requirement comprises the expected movement in the Capital Financing Requirement (CFR) as regards borrowing and any maturing debt that may need to be re-financed. The table below shows this effect on the treasury position over the next three years. It also highlights the expected change in investment balances.

	2008/09 Revised £000	2009/10 Estimated £000	2010/11 Estimated £000	2011/12 Estimated £000
External Debt				
Debt at 1 April	1,000	1,000	1,000	1,000
Movement in CFR	0	0	0	0
Maturing Debt Replacement	0	0	0	0
Adjustment for prior years	0	0	0	0
Debt at 31 March	1,000	1,000	1,000	1,000
Annual change in debt	0	0	0	0
Total Investments at 31 March	500	400	375	350
Investment change	(3,160)	(100)	(25)	(25)

2.2 The related impact of the above movements on the revenue budget are:

	2008/09 Revised £000	2009/10 Estimated £000	2010/11 Estimated £000	2011/12 Estimated £000
Revenue Budgets				
Interest on Borrowing	221	181	136	99
Less Related HRA Charge	(131)	(129)	(129)	(99)
Net General Fund Borrowing Cost	90	52	7	0
Investment income	350	210	200	225

3.0 Expected Movement in Interest Rates

3.1 On 5th February 2009 the Bank of England reduced base interest rates to 1%, the lowest level in the Bank's history. This latest reduction was the Bank's continuing attempt to help aid an economic recovery.

3.2 The Bank's last rate cut followed reductions in November and December 2008, together with a 1/2% fall in January. The totality of the reductions were due to the severe downturn in the global economy with output in the advanced economies having fell sharply in the fourth quarter of 2008 and growth in the emerging market economies having slowed significantly

3.3 In addition, the Bank pointed to the weakness of the global banking and financial system continuing to constrain the supply of credit.

3.4 In the United Kingdom, output dropped sharply in the fourth quarter of 2008 and business surveys point to a similar rate of decline in the early part of this year. Credit conditions faced by companies and households has tightened further.

3.5 The underlying picture for consumer spending appears weak. Businesses have responded to the worsening outlook by running down inventories, cutting production, scaling back investment plans and shedding labour.

3.6 CPI inflation fell to 3.1% in December and is expected to fall further. Sterling has continued to depreciate, and the Bank expects some further volatility in the short-term.

3.7 Although the bank noted that Government intervention in the financial markets had yet to show signs of working, the recent cuts in lending rates would in due course have a significant impact. Together with other iniatives such as the temporary reduction in VAT, the Bank felt that this would provide a considerable stimulus to activity as the year progressed.

3.8 As interest rates have never been closer to zero, this is new ground for the Bank and therefore, their next move will be very difficult to predict.

4.0 Borrowing Strategy 2009/10 – 2011/12

4.1 For several years, the Council has not been required to enter into any form of long-term borrowing and in fact repaid all of its long-term Government debt in March 2004. This was due to substantial capital receipts that the Council had generated, a significant proportion of which had been set-aside to repay debt in accordance with accounting regulations.

4.2 These receipts were placed on deposit and earned interest for the Council's revenue funds. In addition, these receipts have effectively been used to finance new capital expenditure and to meet the Council's shorter-term cash flow requirements when this was negative.

4.3 The only remaining debt outstanding is one money market loan for £1m. This is a fixed rate loan at 4.875%, maturing in 2032 with interest payments of £48,750 per year.

4.4 The Prudential System for Capital Finance provides flexibility for local authorities to borrow. Effectively, councils can borrow money as long as they are able to demonstrate that the associated interest and principal repayments are affordable and sustainable within their longer-term financial resources.

4.5 The Council's approved Capital Investment Strategy does contain provision for prudential borrowing, mainly on an "invest to save" basis, i.e. the cost of loan finance is met from the payback of the investment (efficiencies, greater income, etc).

4.6 The Council's current financial plan to 2014 does not however, currently include any provision for prudential borrowing.

4.7 It is unlikely that the Council will receive any new borrowing allocations from the Government, all Government funding for capital investment purposes will be provided in the form of grant in accordance with their funding policy.

4.8 Therefore, given the positive cash flow position, it is unlikely that the Council will need to borrow for capital purposes over this period.

4.9 In the light of the above, it is proposed that the Council's borrowing strategy for 2009/10 should be based on the following criteria:

- Meeting the Council's cash flow requirements, primarily through its Investment Strategy.
- Reviewing options for the outstanding money market loan of £1m.

Money Market Loan

4.10 Potentially, there is a break clause. The lender has the option of reviewing the interest rate at any time and increasing it if they so wish. However, the Council then has the option of rejecting this and can instead choose to repay without incurring any penalty.

4.11 The current strategy is that should the lender exercise their option to increase the interest rate, then the loan should be repaid at that time. It is proposed that this strategy continues to be adopted.

5.0 Investment Counterparty and Liquidity Framework

5.1 The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Council will ensure:

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections below.

Specified Investments

5.2 The purpose of specified investments is to identify investments offering high security and high liquidity. These investments should be in sterling and with a maturity of no more than a year.

5.3 They are intended to be used with minimal procedural formalities. Any investments made with the UK Government, another local authority or parish council automatically counts as specified investments.

5.4 In addition, short-term investments with bodies or investment schemes with “high credit ratings” will count as specified investments. However, it is left to each authority to determine these institutions, and the Council must determine investment limits and how frequently these ratings are to be monitored.

5.5 The Council’s approved lending list covers this, through one of the 3 recognised credit rating agencies under the regulations, i.e. the “Fitch” IBCA Rating.” Using this agency, the Council will also monitor the outlook or watch rating on an on-going and regular basis to determine whether the institution provides a safe investment.

Non-Specified Investments

5.6 Basically, these are all other investments not meeting the above criteria. Due to the fact that these investments could carry more risk than specified ones, the Council needs to set limits on these investments and determine guidelines on when they should be used.

5.7 The regulations make it clear that they do not wish to discourage authorities from using non-specified investments. The aim is to ensure that proper procedures are in place for undertaking risk assessments of investments made for longer periods or with bodies that do not carry such a high credit rating.

5.8 Based on these regulations, the following strategy is proposed. This is to meet the statutory requirements of the 2003 Act.

6.0 Investment Strategy 2009/10

6.1 The Council is expected to have a regular short-term investment requirement to enable it to manage its day-to-day financial affairs. There is no current proposal to enter into longer term and externally managed funds.

6.2 The current approved investment list is based on best practice and is serving the short-term investment needs of the Council. It is kept under review and will be updated in line with the Treasury Management Policy Statement if and when necessary.

6.3 The approved lending list and policy is shown at **Appendix 3.** In accordance with regulations, it sets out where the Council will invest surplus funds and places limits upon the various institutions. A summary is shown in the following table.

Institution	**Limit**
Specified Investments • UK Debt Management Office (DMO) • Local, Police, Fire and Parish Authorities • Other Bodies with a High Credit Rating of F1+/AA-	 £10m £5m £7.5m

Non-Specified Investments	
• F1/AA Rated Bodies – First Call	£2m
• F1/A Rated Bodies – Second Call	£1m
• F2/A Rated Bodies – Third Call	£0.25m

Definition of Credit Ratings

6.4 The long-term rating is based on an investment grade categorised by “Fitch” on the following scale.

- AAA: the best quality companies, reliable and stable
- AA: quality companies, a bit higher risk than AAA
- A: economic situation can affect finance
- BBB: medium class companies which are satisfactory at the moment.

6.5 Intermediate modifiers are also used for each category between AAA and BBB (i.e. AA+, AA, AA-, A+, A, A-, etc.).

6.6 Short-term credit ratings indicate the potential level of default within a 12-month period, based on the following scale.

- F1+: best quality grade, indicating exceptionally strong capacity to meet financial commitments.
- F1: best grade, indicating strong capacity to financial commitments.
- F2: good quality grade with satisfactory capacity to financial commitments.

6.7 The scale then falls from F3 to B, then C and finally down to D, which indicates the institution is likely to, or as failed to meet its financial commitments.

General Policy

6.8 As approved, priority is given to specified investments in any investment decision. The length of investment is made in accordance with overall cash flow requirements.

6.9 The Council’s policy is to seek investments with those institutions graded at least AA and F1+.

Use of Non-Specified Investments

6.10 This generally covers building societies and the merchant or secondary-banking sector. It is proposed that these are only used as a “lender of last resort” and in the order listed in the above table.

6.11 In particular this may be the case where limits on specified investments are likely to be exceeded and where there is a temporary need to place money.

6.12 It should be noted that F1 and F2 credit ratings are still considered to be fairly high ratings for short-term deposits.

Performance Indicators

6.13 The main indicator is for the return on short-term investments to, average over the year, the Market 7-Day Rate, this being a standard measure of performance. Performance in recent years is shown in the following table.

	2003/04	2004/05	2005/06	2006/07	2007/08
7-Day Rate (target)	3.51%	4.47%	4.44%	4.82%	5.45%
Actual Rate	3.55%	4.63%	4.50%	4.86%	5.79%

APPENDIX 3

APPROVED LENDING LIST & POLICY

1. Approved Types of Investment

The Council may use the following types of investment when managing funds:

- Fixed Term Deposits
- On Call Deposits

2. Approved Institutions for Investment

The Council may invest surplus cash with the following institutions, subject to the provisions within the investment policy in 3 below:

- UK Debt Management Office (DMO);
- Local Authorities and Police Authorities within the UK;
- Major clearing banks incorporated in the UK and their subsidiaries (use of non-British banks is subject to the assessment and approval of the Head of Finance)**;**
- UK Building Societies;
- British Merchant Banks and Securities House Association members;
- The secondary banking sector (use of non-British banks is subject to the assessment and approval of the Head of Finance).
- Foreign Banks with an F1+ Rating (subject to the assessment and approval of the Head of Finance).

3. Investment Policy

The following limits apply on the amount of money that can be invested with any one institution mentioned above, by the designated officers:

• UK Debt Management Office (DMO)	£10M
• Highest quality financial institutions	£7.5M
• Local authorities and police authorities	£5M
• 100% owned subsidiaries of clearing banks	£2M
• F1/AA rated building societies	£2M
• F1/A rated building societies	£1M
• Unrated building societies	£1M
• F1 /A rated merchant or secondary banks	£1M
• F2/A rated merchant or secondary banks	£0.25M

NOTE

➢ The highest quality financial institutions must have a minimum short-term "Fitch" IBCA rating of F1+ and a long-term rating of AA-