APPENDIX

Treasury Management Strategy Statement

2009/10

TREASURY MANAGEMENT STRATEGY STATEMENT

1. Introduction

The Council has customarily considered an annual Treasury Strategy Statement under the requirement of the CIPFA Code of Practice on Treasury Management, which was adopted by the Council on 9 April 2003. The 2003 Prudential Code for Capital Finance in local authorities has introduced new requirements for the manner in which capital spending plans are to be considered and approved, and in conjunction with this, the development of an integrated treasury management strategy.

The 2003 Prudential Code requires the Council to set a number of Prudential Indicators, certain of which replace the borrowing/variable interest limits previously determined as part of the strategy statement, whilst also extending the period covered from one to three years. This report does therefore incorporate the indicators to which regard should be given when determining the Council's treasury management strategy for the next 3 financial years.

The suggested strategy for 2009/10 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 advisers. The strategy covers:

- treasury limits in force which will limit the treasury risk and activities of the council;
- Prudential Indicators;
- the current treasury position;
- the borrowing requirement;
- prospects for interest rates;
- the borrowing strategy;
- the investment strategy;

2. Treasury Limits for 2009/10 to 2011/12

It is a statutory duty under S.3 of the Local Government Act 2003**,** and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit".

The Council must have regard to The Prudential Code when setting its Affordable Borrowing Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future Council Tax levels is 'acceptable'.

Whilst termed an “Affordable Borrowing Limit”, the capital plans to be considered for inclusion incorporate those planned to be financed by both external borrowing and other forms of liability, such as credit arrangements. The affordable borrowing limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

3. Prudential Indicators for 2009/10 – 2011/12

The prudential indicators are relevant for the purposes of setting an integrated treasury management strategy. This was adopted on 25 February 2009 by the Full Council.

4. Current Portfolio Position

The weighted average investment portfolio from April 2008 to March 2009 is estimated at £32,070.00. Listed below are the year end investment balances and the rate of return for the financial year 2008/2009 (estimated) together with a comparison of the position at 2007/08 year end:

	31 March 2008	**31 March 2009**
Investment Portfolio Actual As At	£23,030,000	£28,070,000
	1 April 2007 to 31 March 2008	**1 April 2008 to 31 March 2009**
Average return core on investments	5.61%	5.33%
Average London interbank 3-month offer rate	6.02%	5.20%
Average London interbank 6-month offer rate	6.01%	5.34%

The average return on core investments achieved in the current year to date exceeded the budgeted rate of 5.25% by 0.08% and was above the London three month interbank offer rate by 0.13%. The interbank 3 month and 6 month offer rates continue to reflect the uncertain movement in the bank base rate as mentioned in paragraph 6.

5. Borrowing Requirement

The average short-term loan for 2008/09 was £ 960,000. Although this appears to be rather excessive in borrowing terms it was given to us to hold as a retainer from Bushey Golf & Country Club.

6. Prospects for Interest Rates

The current bank base rate is 1.00%. (Compared against 2008-2009 at 4.50%)

On 5th February 2009 the Bank of England, reduced interest rates by 50 basis points in a move to alleviate some of the problems associated with the current credit crisis and to try and stimulate global economic growth. This is the 5th consecutive rate cut and the lowest level in the history of the Bank of England.

At the date of this report, inflation concerns ease and the general economic condition, both at home and globally, worsening. House prices have continued to slide and levels of unemployment are expected to exceed 2 million, further damping consumer and business confidence.

With US and Japan already having slashed rates to all but zero percent there is a growing belief that UK rates will bottom out at 0.50%, with some analysts suggesting that, given the severity of the recession, the rate could also reach zero percent in the UK.

The following table sets out forecasts of Sector, (the Council's treasury management advisors), UBS, and Capital Economic, an independent forecasting consultant. For the purpose of preparing this strategy the Council has used an average of the forecasts.

Base Rate Forecast	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Sector	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%
UBS	0.50%	0.50%	0.50%	0.50%	n/a	n/a	n/a
Capital Economics	0.50%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Average	0.50%	0.33%	0.33%	0.33%	0.16%	0.25%	0.33%
Forecast Used by HBC	**0.50%**	**0.50%**	**0.50%**	**0.50%**	**0.25%**	**0.25%**	**0.50%**

Sector's current interest rate view is that the Bank Rate will fall from current levels because of the intensifying global recession. At the start of 2009 the Bank rate was 2.00% and is forecast to fall to 0.5% in Q1 2009. It is expected to remain at 0.5% then start to rise gently up from Q2 2010 till it reaches 4.0% in Q1 2012. There is a down side risk to these forecasts if the recession proves to be deeper and more prolonged than currently expected.

The Council have forecast, in their budget, that the return on investment for 2009/2010 will be an average of 2.50%

7. Capital Borrowings and the Borrowing Portfolio Strategy

Although it is anticipated that there will be no capital borrowings required during 2009/2010, based upon the prospects for interest rates outlined above, there are a range of options available for a borrowing strategy for 2009/10 if the need does arise.

- Rates are expected to be slightly lower at the middle to end of the year so it may be advantages to borrow later in the year.

- Variable rate borrowing is expected to be cheaper than long term borrowing and will therefore be attractive throughout the financial year compared with taking long term fixed borrowing

- With historically low long term rates, there is expected to be little difference between 25 year and 50 year rates. Despite the more expensive new borrowing rates expected in the 25-30 year period later in the year, these may be seen as being more attractive then the 50 year borrowing as the spread between the PWLB new borrowing and early repayment rates is considerably less.

The current PWLB (Public Works Loan Board) interest rate forecasts are shown on Appendix A.

Against this background caution will continue to be adopted with the 2009/10 treasury operations. The Head of Financial Services will monitor the interest rate market and adopt a pragmatic approach to any changing circumstances, reporting any decisions to the Executive at the next available opportunity.

This is reflected in the approach taking in 2008/09 to invest short term in order to monitor risks associated with the changing financial markets. The change in investment risk as also been highlighted by the 2 additional amendments to the Strategy approved by Full Council on 19th November 2008 and 25 February 2009.

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

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

- if it was felt that there was a significant risk of a sharp fall in long and short term rates, due to e.g. growth rates weakening, then long term borrowings will be postponed, and any rescheduling from fixed rate funding into variable or short rate funding will be considered.

However, after the freezing of investments by Icelandic banks now in receivership, concern has been shown about the safety of investments and the ability to rely on credit ratings as a basis for ensuring that investments can be undertaken safely, especially for longer periods of time.
(It should be noted that at present the Council is debt free).

8. Temporary Investment Strategy

The Council will have regard to guidance issued by DCLG's under section 15(1)(a) of the Local Government Act 2003, and CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectional Guidance Notes (the "CIPFA TM Code"). The Council's priorities are to secure its capital and the liquidity of its investments. The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

The borrowing of monies to invest or on-lend and make a return is unlawful and the Council will not engage in such activity.

At present the money market is volatile, and as discussed earlier the forecast base rates are set to reduce further in the short and medium term. A return to an increased base rate is predicted to be a slow process.

The risk of default remains a concern; if 10% of the Councils portfolio of £28m were to default then the potential loss could be £2m – £3m.

9. Counterparty Risk Assessment

The current guidelines are based on the proposals previously agreed by the Full Council on 31 July 2004 with the list of qualifying counterparties having been regularly updated from data supplied by Sector Treasury Services Ltd. These guidelines are reviewed (as part of an ongoing process) to reflect the Council's current financial position and outlook, in light of the ever changing financial sector environment. This will allow the Council's funds to be invested in a diversified manner with the appropriate counterparties so that risk and return are balanced.

It is anticipated that total funds available for core investment will remain stable year on year, with £24m budgeted for 2009/10 compared with £20m in 2008/09.

In accordance with prudent practice, counterparties are sourced from a list of eligible countries - those that are economically stable and have a well regulated financial sector. Also taken into consideration when establishing creditworthiness, is the Sovereign rating of the country, with a preference to use AAA rated counties.

Financial institutions are classified, depending on their main area of activity, in one of the following sectors:

- UK Banks (including wholly owned subsidiaries)
- Foreign Banks
- Building Societies
- Local and other Public Authorities

Investments will be made with institutions that meet the Council's credit rating criteria. Credit ratings are provided by Fitch IBCA (international rating agency) and fall into the following four categories:

- **Short Term and Long Term** – the ability to meet short and long term financial obligations.
- **Individual (intrinsic)** - the likelihood of the need for external support
- **Legal/Support (external)** - the likelihood that support is forthcoming from owner or government

Each of the ratings above need to be taken into account when assessing an investment term and limit with any counterparty. Fully nationalised banks in the UK have credit ratings which do not conform to the credit criteria used to identify banks which are of high credit worthiness. As they no longer are separate institutions in their own right, it is not possible for Fitch to assign an individual rating for their stand alone financial strength. Fitch has assigned an individual rating of 'F' which means that at a historical point of time, the bank has failed and is now owned by the Government. However, these institutions receive a 'F1+' short term rating as effectively they are ranked on the creditworthiness of the Government itself. Also with a support rating of '1' they have the highest possible rating. Where a bank has been substantially nationalised (greater than 50% ownership), Fitch have assigned an individual rating of 'E' indicating that the bank requires external support. As with fully nationalised banks, these institutions have also received a short term rating and support rating of 'F1+' and '1' respectively, again representing the highest possible rating for the criteria.

Some countries have supported their banking system by giving a blanket guarantee on ALL deposits e.g. Ireland. Therefore the Sovereign rating may be used to underpin creditworthiness.

The Council uses the following matrix provided by its treasury management advisor. (Note that an extra category has been added to reflect counterparties that are backed/partly owned by the UK Government as approved by Full Council on 25 February 2009)

Lending term limits up to one year (specified investments)

Short Term:	F1+
Long Term:	AAA,AA+,AA,AA-

	Support			
Individual:	**1**	**2**	**3**	**4**
A	*3 Months*	*3 Months*	*3 Months*	
A/B	*3 Months*	*3 Months*	*1 Months*	
B	*3 Months*	*3 Months*	*1 Months*	
B/C	*3 Months*	*3 Months*	*1 Months*	
C	*3 Months*	*3 Months*	*1 Months*	
C/D				
D				
E	*3 Months*			
F	*3 Months*			

Short Term:	F1
Long Term:	A+, A

	Support			
Individual:	**1**	**2**	**3**	**4**
A	*3 Months*	*3 Months*	*1 Months*	
A/B	*3 Months*	*3 Months*	*1 Months*	
B	*3 Months*	*3 Months*	*1 Months*	
B/C	*1 Months*	*1 Months*		
C	*1 Months*	*1 Months*		
C/D				
D				
E	*1 Months*			
F	*1 Months*			

Lending term limits longer than one year (non-specified investments)

Short Term:	F1+
Long Term:	AAA,AA+,AA,AA-

	Support			
Individual:	**1**	**2**	**3**	**4**
A	*1 Year*	*1 Year*		
A/B	*1 Year*	*1 Year*		
B	*1 Year*	*1 Year*		
B/C	*1 Year*	*1 Year*		
C				
C/D				
D				
E	*1 Year*			
F	*1 Years*			

Short Term:	F1
Long Term:	A+, A

	Support			
Individual:	**1**	**2**	**3**	**4**
A	*6 Months*	*6 Months*		
A/B	*6 Months*	*6 Months*		
B	*6 Months*	*6 Months*		
B/C	*6 Months*	*6 Months*		
C				
C/D				
D				
E	*6 Months*			
F	*6 Months*			

COUNTERPARTY CREDIT LIMITS

The individual counterparty exposure limits apply only to the principal invested and are secondary to the following overall restrictions.

No more than 30% of the total portfolio is to be invested in any one country, except the UK.

No more than 75% of the total portfolio is to be invested in any one sector.

For rated institutions the table below shows their assigned credit limit dependent upon which ‘credit band’ they currently fall into. This credit limit is also the overall group limit applicable to the cumulative total of the parent and subsidiaries’ exposures. Increasing numbers of banks are merging which results in a reduction of available counterparties. This flexible approach will allow for counterparties to migrate between bands as their credit quality varies and for the band limits to be easily adjusted to reflect changes in the size of the total portfolio or the Council' s investment policy.

#	SHORT TERM	LONG TERM	INDIVIDUAL	LEGAL/ (SUPPORT)	CREDIT LIMIT
1	F1+	AAA	A,A/B,B	1,1/2,2	£8M
2	F1	AA+,AA	A,A/B,B,E[1]	1,1/2,2	£6M
3	F1	AA-	A,A/B,B,B/C	1,1/2,2	£3M
4	F1	A+,A	A,A/B,B	1,1/2,2	£1M
5	DMO	N/A	N/A	N/A	£10M

Non-rated institutions such as Local and other Public Authorities meet the criteria for the highest counterparty credit limit, namely £8m.

Where the institutions criteria falls under numer 2 above, investment priority will be given to UK clearing banks, for example Barclays Bank plc.

E[1] Banks with an individual rating of 'E' will only fall under criteria 2 above, where they have been part nationalised (> 50% ownership) and where their short term and support ratings are 'F1+' or 'F1' and '1' respectively.

Building Societies, in general, are also not rated but the industry is highly regulated and well supervised by the Building Societies Commission. The top 19 building societies meet the proposed qualifying criteria, with total assets in access of £1 billion, and as such qualify for an individual counterparty exposure limit of £2m. However as far as possible the Council will invest in Building Societies that are rated by Fitch, followed by the preference to use the Top 10 by asset base.

Other Issues

Investment guidance was issued under the Local Government Act 2003, which requires that the full Council should approve the Council's annual investment strategy. The Capital Finance and Accounting Regulations 2003, which came into force on 1 April 2004, also include provisions relating to local authority investments. From this date investments are classified by the Government into two categories, Specified and Non-Specified.

<u>Specified Investments</u>

These will have high security and high liquidity, denominated in sterling not a long term investment i.e. maturity date of no more than 12 months. The investment is not defined as capital expenditure.

The investment is to be made with:

- The UK Government
- Debt Management Office Accounts

- UK Local Authorities and Parish Councils
- Institutions or investment schemes with a credit rating that meets the criteria mentioned above.

Non-specified Investments

All other investments not covered above. The Council's policy is to invest in non-specified investments, which meet all the criteria of a specified investment except for the maturity date, which is longer than 12 months. It is therefore recommended that the Council continues with its practice of investing for no longer than 5 years, and where possible spreading the amount and dates of maturing investments as evenly as possible over this period. This avoids an excess of investments maturing in any one particular year and helps towards a more stable rate of return. For all investment transactions the optimum period must be considered in the light of cash flow and market conditions, and alternative investment products.

Note – The Council currently has £1m invested in the frozen Icelandic Bank, Heritable Bank. The Icelandic Government has stated its intention to honour all its commitments as a result of their banks being placed in receivership. The UK Government is working with the Icelandic Government to help bring this about. At the current time it is not possible to say with certainty that we will recover the entirety of our investment or when reimbursement will be made.

Individual Forecasts

The data below shows a variety of forecasts published by a selection of institutions: Sector; UBS and Capital Economics (an independent forecasting consultancy).

Sector View interest rate forecast – January 2009

(%)	Q1 2009	Q2 2009	Q3 2009	Q4 2009	Q1 2010	Q2 2010
Base Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%
10yr PWLB	3.10%	2.75%	2.55%	2.55%	2.55%	2.85%
25yr PWLB	4.00%	3.95%	3.95%	3.95%	4.00%	4.15%
50yr PWLB	3.85%	3.80%	3.80%	3.80%	3.85%	3.90%

Capital Economics interest rate forecast – January 2009

(%)	Q1 2009	Q2 2009	Q3 2009	Q4 2009	Q1 2010	Q2 2010
Base Rate	0.50%	0.00%	0.00%	0.00%	0.00%	0.00%
10yr PWLB	2.65%	2.15%	2.15%	2.15%	2.15%	2.15%
25yr PWLB	4.15%	4.00%	3.80%	3.65%	3.65%	3.65%
50yr PWLB	4.05%	3.95%	3.85%	3.75%	3.75%	3.75%

UBS Economic interest rate forecast – January 2009

(%)	Q1 2009	Q2 2009	Q3 2009	Q4 2009	Q1 2010	Q2 2010
Base Rate	0.50%	0.50%	0.50%	0.50%	-	-
10yr PWLB	3.75%	4.15%	4.35%	4.65%	-	-
25yr PWLB	4.25%	4.55%	4.85%	5.05%	-	-
50yr PWLB	4.30%	4.65%	5.00%	5.25%		-

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