Appendix A

Quarterly Treasury Report Q3 2010/11

1. Background

The Treasury Management Strategy for 2010/11 has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year.

The Code of Practice recommends that members should be informed of Treasury Management activities at least twice a year, but preferably quarterly. This report therefore ensures this authority is embracing Best Practice in accordance with CIPFA's recommendations.

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."

2. Economic Background

- The Comprehensive Spending Review announced on 20 October 2010 set out how the Coalition Government will carry out the UK's deficit reduction plan over the next 4 years with the aim of eliminating the structural deficit by 2015. Particular focus was given to "reducing welfare costs and wasteful spending". Departmental budgets (other than health and overseas aid) are to be cut by an average of 19%, with around £81 billion cut from public spending overall, over 4 years resulting in a loss of around 490,000 public sector jobs. The Office of Budget Responsibility's (OBR), the new fiscal watchdog, verdict on the CSR was that there was a better than even chance of hitting the fiscal mandates and that the rebalancing of the economy could be relatively pain-free.
- The Bank of England's November Quarterly Inflation Report showed inflation remaining above the 2% target throughout 2011. In the Bank's view the recovery in economic activity was likely to continue, with GDP growth more likely to be above the historical average than below it for much of the 2-year forecast period.
- The headline inflation rate, Consumer Price Inflation (CPI), rose to 3.3% year-on-year to November 2010 and was expected to remain at a discomfortingly high rate into 2011. However, wage inflation remained benign with annual rate for average weekly earnings only 2.2% to October 2010.
- The UK economy grew in the third calendar quarter of 2010 by 0.8%, twice as much as economists forecast, as services and construction helped sustain the recovery's momentum. The annual growth rate increased to 2.8%. The Monetary Policy Committee maintained the Bank Rate at 0.5%, and although the MPC maintained Quantitative Easing at £200bn, minutes

of the Committee's meetings showed the MPC was clearly ready to resume asset purchases if the economy slowed faster than expected.

3. Debt Management

PWLB Borrowing Rates post-CSR : Announced in the Spending Review on 20th October was the instruction from HM Treasury to the PWLB to increase the interest rate on all new loans by an average of 1% above UK Government Gilts. PWLB Circular 147 was released on the same day which detailed the changes to the rate setting system. The new borrowing rates for fixed loans increased by approximately 0.87% across all maturities, and variable rates by 0.90%. Premature repayment rates did not benefit from the corresponding increase and the PWLB's methodology remained unchanged. HM Treasury determined that these changes ensured that the rate at which loans are made available to local authorities better reflected the availability of capital funding post-Spending Review and would encourages optimal borrowing and investment decisions.

Whilst there are an increasing series of claims that a competitive, comparable equivalent to PWLB is readily available, the Council will adopt a cautious and considered approach to funding from the capital markets. The Council's treasury advisor, Arlingclose, is actively consulting with investors, investment banks, lawyers and credit rating agencies to establish the attraction of different sources of borrowing, including bond schemes, loan products and their related risk/reward trade off.

Currently the use of internal resources in lieu of borrowing has been the most cost effective means of funding of capital expenditure. This has lowered overall treasury risk by reducing both external debt and temporary investments. However, this position will not be sustainable over the medium term and the Council expects it will need to borrow for capital purposes during 2011/12.

£35.6m of PWLB fixed rated loans was rescheduled last year at an average rate of 0.7% which mitigate the impact of changes in variable rates on the Council's overall treasury portfolio (the Council's investments are deemed to be variable rate investments due to their short-term nature. Due to the fact that the Council's variable rate loans were borrowed prior to 20/10/2010 (the date of change to the PWLB's lending arrangements post CSR) the variable rates payable are maintained on their initial terms and are not subject to the additional increased margin. Variable rate borrowing is expected to remain attractive for some time as the Bank of England maintains the base rate at historically low levels. This strategic exposure to variable interest rates will be regularly reviewed and, if appropriate, reduced by switching into fixed rate loans.

This Debt rescheduling has generated revenue savings of £1.083m (£1.007m after premium write off) in the current year to the end of December.

The rescheduling activity complies with the Local Government accounting and regulatory requirements.

4. Investment Activity

The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

The UK Bank Rate has been maintained at 0.5% since March 2009. Short-term money market rates have remained at very low levels. Despite this, internally new deposits for periods up to one year have been made between 0.8% - 2.2%.

The council has been able to obtain average rate of return over its set benchmark of 3 month LIBID (currently 0.66%), the Council's average rate of return being 1.52% (which was received overall on internal investments and monies in call accounts).

Long term investment:

Lime Fund - The Council's Investment in the Lime Property Fund, continues to generate a good return. The second quarter's return was distributed in November which was consistent to the first quarters which mean year to date to the end of September the return on the investment was 5.49% before fees and 4.76% after fees.
As the property market picks up, the fund has also continued to grow in value albeit slowly, over the year to 31 December 2010. It has increased by £59k in capital terms (which is unrealised). Although the value of the fund remains below its initial investment value of £5m at the end of December it should be noted that the nature of the investment is long term.

Externally Managed Funds:

Investec – The Council had an amount of money managed by a fund manager who traded on the open market buying and selling primarily certificates of deposits and commercial papers. The fund was structured in a way which historically generated a good return due to changes in the market the performance of the fund over the last few years deteriorated significantly.

The Council has undertaken an ongoing review of the externally managed fund the council with its advisors. Following this review it was decided to withdraw its fund from Investec and bring the money in-house. The reasons for this change were twofold. Firstly the costs associated with restructuring the funds were very high, and secondly the increase in liquid internal funds would allow the council to use the funds in lieu of borrowing which was the most cost effective means of using the funds.

Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2010/11. This restricted new investment to the following:

- the Debt Management Office

- Other Local Authorities
- AAA-rated Stable Net Asset Value Money Market Funds
- Deposits with UK Banks and Building Societies systemically important to the UK banking system and deposits with select non-UK Banks (Australia, Canada, Finland, France, Germany, Netherlands, Spain, Switzerland and the US).

  Counterparty credit quality is assessed and monitored with reference to: Credit Ratings (Council's minimum long-term counterparty rating of A+ across all three rating agencies, Fitch, S&P and Moody's); Credit Default Swaps; GDP of the country in which the institution operates; the country's net debt as a Percentage of GDP; Sovereign Support Mechanisms /potential support from a well-resourced parent institution; Share Price.
- Bonds issued by Multilateral Development Banks, such as the European Investment Bank
- Pooled funds (collective investment schemes) meeting the criteria in SI 2004 No 534 and subsequent amendments

Counterparty Update

- The Council added one new UK banks to the approved counterparty list in Q3 2010/11: Standard Chartered Bank. Currently no money has been invested with them.

  - The long-term rating for Standard Chartered Bank was upgraded to A1 (A+ equivalent) by Moody's in November, due to its recent $5.2bn rights issue. The Bank is strongly positioned to accommodate increases in capital requirements as a result of regulatory changes. Standard Chartered was one of the eight UK institutions given automatic access to the UK Government's Credit Guarantee Scheme (CGS) in October 2008, meaning that it could be deemed to be of systemic importance to the UK Banking System.

5. Compliance with Prudential Indicators

The Council can confirm that it has complied with its Prudential Indicators for 2010/11, which were set in 25th February 2010 as part of the Council's Treasury Management Strategy Statement.

The Council's 2011/12 Treasury Management Strategy, Policy and Prudential Indicators was approved in February 2011.

6. Outlook up to 2012/13

The outlook for interest rates is as follows:

Table 3 Outlook for Interest Rates

	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Mar-13
Official Bank Rate											
Upside risk	-	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**0.50**	**0.50**	**0.50**	**0.75**	**1.00**	**1.25**	**1.50**	**2.00**	**2.50**	**2.75**	**2.75**
Downside risk	-	-	-	- 0.25	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50

- The recovery in growth is likely to be slow, uneven and more “Square root” than “V” shaped.
- The path of base rates reflects the fragility of the recovery and the significantly greater fiscal tightening of the emergency budget. With growth and underlying inflation likely to remain subdued, the Bank will stick to its lower for longer stance on policy rates.
- Uncertainty surrounding Eurozone sovereign debt and the risk of contagion will remain a driver of global credit market sentiment.
- The economy has been growing at around or a little above trend during 2010. However, the outlook for growth remained highly uncertain and inflation remained above the 2% target. Banks still face a significant challenge in repairing their balance sheets, but funding conditions had eased in recent months, potentially easing some of the limitations to growth from constrained credit supply.
- Consumer Price Inflation is stubbornly above 3% and will likely spike above 4% in January 2011 as VAT, Utilities and Rail Fares are increased.
- Unemployment remains near a 16 year high at just under 2.5 million, and is set to increase further as the Public Sector shrinks. Meanwhile, employment is growing but this is due to part time work, leaving many with reduced income.

7. <u>Other Information</u>

- **Reform of Council Housing Finance –**The CLG published a summary of responses to the consultation held between March and July 2010 on proposals for the reform of the current system of council housing finance. There was widespread agreement with the general methodology proposed in the Prospectus. Many of the reservations related to assumptions about costs and the affordability of allocated debt. There was broader acceptance that a level of housing debt redistribution was an acceptable or necessary price to pay for the freedoms and benefits that the reforms would bring and there was strong support for retaining and clarifying the operation of the HRA ring fence.

  The Housing Minister confirmed that the new system of HRA self-financing will be most likely implemented in 2012. Full details of the Government’s policy on reforming council housing finance will be published in early 2011.

  In the Consultation the PwC self-financing model provides an indicative sustainable level of opening housing debt. As the Council’s debt level generated by the model is higher than the Subsidy Capital Financing Requirement (SCFR), the Council will be required to pay the CLG the difference between the two, which could be between £150-180m. This will require the Council to fund this amount in the medium term through internal resources and/or external borrowing. The Council has the option of borrowing from the PWLB or the market. The type of loans taken will be decided on in discussions with the Housing department and the councils’ Treasury Advisors.

Annex A

Prudential Indicator Compliance

(a) Authorised Limit and Operational Boundary for External Debt

- The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached.
- The Council's Affordable Borrowing Limit was set at £221m for 2010/11.
- The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit.
- The Operational Boundary for 2010/11 was set at £211m.
- There were no breaches to the Authorised Limit and the Operational Boundary during the period from 01/04/10 to 31/12/10; borrowing at its peak was £169.3m.

(b) Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

- These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.
- The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

Table 1 - Upper Limits for Interest Rate Exposure

	Limits for 2010/11 %
Upper Limit for Fixed Rate Exposure	**100**
Compliance with Limits:	**Yes**
Upper Limit for Variable Rate Exposure	**35**
Compliance with Limits:	**Yes**

(c) Maturity Structure of Fixed Rate Borrowing

- This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates. The maturity of the Councils borrowing is profiled in order that no more than 20% matures in any one financial year.

Table 2 – Maturity Structure of Fixed Rate Borrowing

Maturity Structure of Fixed Rate Borrowing	Actual Fixed Rate Borrowing as at 31/12/10	% Fixed Rate Borrowing as at 31/12/10	Compliance with Set Limits?
under 12 months	6	0.00	Yes
12 months and within 24 months	651	0.42	Yes
24 months and within 5 years	28,973	18.54	Yes
5 years and within 10 years	16,060	10.28	Yes
10 years and within 15 years	12,734	8.15	Yes
15 years and within 20 years	19,398	12.41	Yes
20 years and within 25 years	2,522	1.61	Yes
25 years and within 30 years	0	0.00	Yes
30 years and above	75,916	48.58	Yes

(d) **Total principal sums invested for periods longer than 364 days**

- This indicator allows the Council to manage the risk inherent in investments longer than 364 days.
- The limit for 2010/11 was set at £20m.
- The Council's policy response since the onset of the credit crunch in 2007 was to keep investment maturities to a maximum of 12 months. No investments were made for a period greater than 364 days during this period.

Money Market Data and PWLB Rates

Table 3 - Bank Rate, Money Market Rates

Date		Bank Rate %		O/N LIBID %	7-day LIBID %	1-month LIBID %	3-month LIBID %	6-month LIBID %	12-month LIBID %	2-yr SWAP Bid %	3-yr SWAP Bid %	5-yr SWAP Bid %
01/04/2010		0.50		0.35	0.35	0.42	0.51	0.81	1.26	1.54	2.07	2.82
30/04/2010		0.50		0.30	0.30	0.43	0.53	0.83	1.29	1.70	2.23	2.95
31/05/2010		0.50		0.45	0.50	0.61	0.60	0.85	1.35	1.46	1.89	2.58
30/06/2010		0.50		0.35	0.35	0.45	0.61	0.94	1.38	1.40	1.79	2.42
31/07/2010		0.50		0.40	0.40	0.50	0.71	1.01	1.46	1.36	1.75	2.39
31/08/2010		0.50		0.40	0.55	0.50	0.71	1.00	1.45	1.20	1.47	2.02
30/09/2010		0.50		0.30	0.25	0.51	0.72	1.01	1.46	1.24	1.51	2.05
31/10/2010		0.50		0.48	0.40	0.51	0.72	1.01	1.46	1.26	1.53	2.08
30/11/2010		0.50		0.40	0.51	0.51	0.72	0.88	1.46	1.32	1.66	2.30
31/12/2010		0.50		0.40	0.40	0.51	0.72	1.01	1.47	1.49	1.94	2.61
Minimum		0.50		0.30	0.25	0.42	0.51	0.75	1.00	1.13	1.37	1.92
Average*		0.50		0.39	0.41	0.49	0.66	0.96	1.40	1.40	1.78	2.42
Maximum		0.50		0.55	0.55	0.80	0.75	1.01	1.47	1.75	2.31	3.04
Spread				0.25	0.30	0.38	0.24	0.26	0.47	0.62	0.94	1.11

*The average, low and high rates correspond to the rates during the financial year and rather than those in the table

Table 4 - PWLB Borrowing Rates – Fixed Rate, Maturity Loans

Change Date	Notice No	1 year %	4½-5 yrs %	9½-10 yrs %	19½-20 yrs %	29½-30 yrs %	39½-40 yrs %	49½-50 yrs %
01/04/2010	064/10	0.81	2.84	4.14	4.21	4.60	4.61	4.63
30/04/2010 12:15	089/10	0.85	2.86	4.13	4.20	4.61	4.61	4.60
28/05/2010 12:15	127/10	0.73	2.46	3.76	3.83	4.36	4.38	4.38
30/06/2010 12:16	171/10	0.67	2.27	3.54	3.62	4.22	4.28	4.27
30/07/2010 12:16	217/10	0.70	2.29	3.55	3.62	4.32	4.41	4.40
31/08/2010 12:15	259/10	0.63	1.84	3.05	3.13	3.82	3.93	3.93
30/09/2010 12:15	303/10	0.64	1.88	3.14	3.86	4.00	4.03	4.02
29/10/2010 12:16	346/10	1.58	2.90	4.23	5.06	5.20	5.22	5.20
30/11/2010 12:15	390/10	1.56	3.05	4.40	5.18	5.26	5.25	5.23
31/12/2010 09:19	430/10	1.65	3.33	4.58	5.18	5.23	5.20	5.16
Minimum*		0.60	1.81	3.05	3.82	3.93	3.93	3.92
Average*		**0.96**	**2.50**	**3.79**	**4.50**	**4.57**	**4.57**	**4.56**
Maximum*		1.77	3.45	4.75	5.41	5.47	5.46	5.43

*The average, low and high rates correspond to the rates during the financial year and rather than those in the table

Table 5 - PWLB Repayment Rates – Fixed Rate, Maturity Loans

Change Date	Notice No	1 year %	4½-5 yrs %	9½-10 yrs %	19½-20 yrs %	29½-30 yrs %	39½-40 yrs %	49½-50 yrs %
01/04/2010	064/10	0.56	2.38	3.82	4.35	4.36	4.26	4.19
30/04/2010 12:15	089/10	0.62	2.43	3.83	4.37	4.38	4.33	4.30
28/05/2010 12:15	127/10	0.50	2.04	3.44	4.12	4.15	4.11	4.10
30/06/2010 12:16	171/10	0.44	1.86	3.23	3.98	4.05	4.00	3.97
30/07/2010 12:16	217/10	0.47	1.88	3.23	4.08	4.18	4.13	4.10
31/08/2010 12:15	259/10	0.40	1.45	2.73	3.57	3.70	3.66	3.62
30/09/2010 12:15	303/10	0.41	1.48	2.82	3.62	3.77	3.76	3.73
29/10/2010 12:16	346/10	0.47	1.61	3.03	3.93	4.09	4.07	4.03
30/11/2010 12:15	390/10	0.45	1.75	3.20	4.06	4.15	4.10	4.06
31/12/2010 09:19	430/10	0.54	2.04	3.39	4.07	4.12	4.05	3.99
Minimum*		0.37	1.40	2.73	3.51	3.70	3.66	3.62
Average*		**0.49**	**1.85**	**3.23**	**4.01**	**4.10**	**4.06**	**4.02**
Maximum*		0.68	2.53	3.94	4.47	4.46	4.38	4.35

The average, low and high rates correspond to the rates during the financial year and rather than those in the table

Table 6 - PWLB Variable Rates

	1-M Rate %	3-M Rate %	6-M Rate %			
01-Apr-2010	0.65	0.65	0.70			
30-Apr-2010	0.65	0.65	0.70			
28-May-2010	0.65	0.65	0.70			
30-Jun-2010	0.65	0.70	0.70			
30-Jul-2010	0.65	0.70	0.70			
31-Aug-2010	0.65	0.65	0.70			
30-Sep-2010	0.65	0.70	0.70			
Borrowing undertaken pre-CSR				Borrowing undertaken post-CSR		
	1-M Rate %	**3-M Rate %**	**6-M Rate %**	**1-M Rate %**	**3-M Rate %**	**6-M Rate %**
29-Oct-2010	0.66	0.67	0.69	1.56	1.57	1.59
30-Nov-2010	0.67	0.67	0.69	1.57	1.57	1.59
31-Dec-2010	0.70	0.70	0.75	1.60	1.60	1.65
Minimum*	0.65	0.65	0.68	1.56	1.56	1.58
Average*	**0.66**	**0.67**	**0.70**	**1.57**	**1.58**	**1.61**
Maximum*	0.70	0.75	0.75	1.60	1.65	1.65

The average, low and high rates correspond to the rates during the financial year and rather than those in the table