CHESHIRE EAST COUNCIL

REPORT TO: CABINET

Date of Meeting:	16 February 2010
Report of:	Borough Treasurer and Head of Assets
Subject/Title:	Treasury Management Strategy 2010/11
Portfolio Holder:	Councillor Keegan

1.0 Report Summary

1.1 To present the Treasury Management Strategy for 2010/11 to 2012/13 including the prudential indicators and limits required under Part 1 of the Local Government Act 2003 and the Annual Investment Strategy 2010/11 and Annual Policy Statement on Minimum Revenue Provision (MRP) for the redemption of debt 2010/11.

2.0 Decision Requested

2.1 Cabinet is requested to recommend to Council the approval of the Treasury Management Strategy and the MRP Statement for 2010/11. The Strategy includes the Department for Communities and Local Government (DCLG) reporting requirements in accordance with the Local Government Investments Guidance under Section 15(1)(a) of the Local Government Act 2003 (Appendix A).

3.0 Reasons for Recommendations

3.1 The Treasury Management Strategy details the activities of the Treasury Management function in the forthcoming year 2010/11. The Strategy for 2010/11 reflects the views on interest rates of leading market forecasts provided by Arlingclose, the Council's advisor on treasury matters. It also includes the Prudential Indicators relating to Treasury Management.

3.2 The CIPFA Code of Practice on Treasury Management, when adopted by a local authority, gives it the status of 'a code of practice made or approved by or under enactment' and hence proper practices under the provision of the Local Government and Housing Act 1989.

4 Wards Affected

4.1 Not applicable

5.0 Local Ward Members

5.1 Not applicable

6.0 Policy Implications including - Climate change
- Health

6.1 Not applicable.

7.0 Financial Implications for Transition Costs (Authorised by the Borough Treasurer)

7.1 None

8.0 Financial Implications 2009/10 and beyond (Authorised by the Borough Treasurer)

8.1 Effective Treasury Management provides support towards the achievement of service priorities, it allows the Council to invest in capital projects without any limit as long as it can demonstrate that its capital expenditure plans are affordable, external borrowing is prudent and sustainable and treasury decisions are taken in accordance with good practice.

9.0 Legal Implications (Authorised by the Borough Solicitor)

9.1 It is a requirement of the CIPFA Code of Practice for Treasury Management in The Public Sector, that Council receives an Annual Report on its Treasury Strategy, that Council sets Prudential Indicators for the next three years and approves an Annual Investment Strategy and an Annual MRP Policy Statement. There are stringent legislative requirements in place which dictate the way that a local authority deals with financial administration.

10.0 Risk Management

10.1 The steps outlined in this report will significantly mitigate the main legal and financial risk to the council's financial management:

a. That council borrowing will comply with the Treasury Management Strategy

11.0 Background and Options

11.1 The Local Government and Public Involvement in Health Act 2007 places a requirement on all councils to approve a policy on how the amount provided in respect of the repayment of debt is calculated prior to the start of the financial year concerned. The Policy for the year 2010/11 is contained in Appendix A. The budgeted provision for the repayment of debt in the year 2010/11 has been broadly calculated as 4% of the estimated outstanding debt at the end of the year 2009/10 with a small number of exceptions. These exceptions comprise capital expenditure on capital projects that has been funded through unsupported borrowing.

11.2 The amount charged in respect of the repayment of debt is currently just above the generally accepted prudent minimum. The amount provided is also below the amount of capital expenditure being funded from borrowing in each of the next few years. As a consequence the amount of debt outstanding is increasing each year. As the level of outstanding debt increases the amount that needs to be provided for the repayment of debt in future years also increases.

11.3 In order to stabilise the Council's borrowing position, the amount of Prudential Borrowing undertaken to finance new capital schemes has been limited to those schemes where efficiency savings within the service will meet the cost of repayments. Capital receipts of £4.6m will be made available to fund new schemes within the 2010/11 programme which will reduce the charge to the Revenue Account.

11.4 **Capital Financing Budget 2010-11**

	£m
Repayment of outstanding debt	7.86
Revenue Funding (net of service contributions)	0.71
Interest on long term loans	7.83
Contribution from services towards the cost of borrowing	(1.70)
Total Debt Repayment	**14.70**
Less Interest receivable on cash balances	(1.12)
Net Capital Financing Budget	**13.58**

11.5 The amount of interest paid on the Council's portfolio of long term loans is mainly at fixed rates of interest (circa 4.9%). This provides a degree of certainty to the capital financing budget. The rate of interest payable on the £21.5 million of new long term loans that it is planned to raise during the year 2010/11 is budgeted to be 4.5%. Currently long term interest rates are around 4.5%. However, within the Treasury Management Strategy, the Council will use internal balances where possible to reduce the costs in the short term of external borrowing.

11.6 The rate of interest to be earned on the Council's cash balances that are temporarily invested pending their being used (estimated at £90 million) is budgeted to be 1.25%.

12.0 ***Access to Information***

The background papers relating to this report can be inspected by contacting the report writer:

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Appendices:

Appendix A – Treasury Management Strategy Statement & Investment Strategy 2010/11-2012/13

APPENDIX A

Treasury Management Strategy Statement and Investment Strategy 2010/11 to 2012/13

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Annexes

1. Background

1.1 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 also incorporates the Investment Strategy as required under the Communities and Local Government (CLG) Investment Guidance. Together, these cover the financing and investment strategy for the forthcoming financial year.

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. CLG has produced draft revisions to Investment Guidance. In the event that the official guidance differs from the draft, changes required to be made to this Strategy and/or documentation will be placed before members for consideration at the next appropriate Cabinet meeting.

1.2 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."

1.3 The Council is responsible for its treasury decisions and activity. No treasury management activity is without risk. The successful identification, monitoring and control of risk is an important and integral element of its treasury management activities. 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)
- Inflation Risk (Exposure to inflation)
- Credit and Counterparty Risk (Security of Investments)
- Refinancing Risk (Impact of debt maturing in future years)
- Legal & Regulatory Risk

1.4 The strategy also takes into account the impact of the Council's Revenue Budget and Capital Programme on the Balance Sheet position, the Prudential Indicators (Annex A) and the outlook for interest rates (Annex B).

1.5 The purpose of this Treasury Management Strategy Statement is to approve:

- Treasury Management Strategy for 2010-11 (Borrowing - Section 4, Debt Rescheduling - Section 5, Investments - Section 6)
- Prudential Indicators – Annex A (NB - PI No. 6 - The Authorised Limit is a statutory limit)
- Use of Specified and Non-Specified Investments – Annexes C & D

2. Balance Sheet and Treasury Position

2.1 The underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) together with Balances and Reserves are the core drivers of Treasury Management Activity. The estimates, based on the current Revenue Budget and Capital Programmes, are set out below:

	31 Mar 10 Estimate £m	31 Mar 11 Estimate £m	31 Mar 12 Estimate £m	31 Mar 13 Estimate £m
CFR	170.2	183.8	191.6	197.0
Balances & Reserves	(55.9)	(40.9)	(43.7)	(34.6)
Net Balance Sheet Position	114.3	142.9	147.9	162.4

2.2 The Council's level of physical debt and investments is linked to these components of the Balance Sheet. Market conditions, interest rate expectations and credit risk considerations will influence the Council's strategy in determining the borrowing and investment activity against the underlying Balance Sheet position.

2.3 As the CFR represents the level of borrowing for capital purposes and revenue expenditure cannot be financed from borrowing, net physical external borrowing should not exceed the CFR other than for short term cash flow requirements. It is permissible under the Prudential Code to borrow in advance of need up to the level of the estimated CFR over the term of the Prudential Indicators. Where this takes place the cash will form part of its invested sums until the related capital expenditure is incurred. This being the case net borrowing should not exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years other than in the short term due to cash flow requirements. The draft revisions to the CLG's Investment Guidance recommend that the Strategy should state the authority's policies on investing money borrowed in advance of need.

2.4 The move to International Financial Reporting Standards (IFRS) has implications for the Capital Financing Requirement components on the Balance Sheet. Analysis of the Council's Private Finance Initiative (PFI) schemes and Operating leases against IFRS requirements may result in the related long term assets and liabilities being brought onto the Council's Balance Sheet. The estimates for the CFR and Long Term Liabilities will therefore need to take into account such items. This will influence the determination of the Council's Affordable Borrowing Limit and Operational Boundary.

2.5 The estimate for interest payments in 2010/11 is £7.8m and for interest receipts is £1.1m.

3. Outlook for Interest Rates

3.1 The economic interest rate outlook provided by the Council's treasury advisor, Arlingclose Ltd, is attached at Annex B. 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.

4. Borrowing Requirement and Strategy

4.1 The Council's underlying need to borrow for capital purposes is measured by reference to its Capital Financing Requirement (CFR) – see Annex 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.

4.2 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 in turn produce an increased requirement to charge MRP in the Revenue Account.

4.3 Physical external borrowing may be greater or less than the CFR, but 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.

4.4 The cumulative estimate of the maximum long-term borrowing requirement is estimated by comparing the projected CFR with the profile of the current portfolio of external debt and long term liabilities over the same financial horizon, as follows:

	31/03/2010 Estimate £m	**31/03/2011 Estimate £m**	**31/03/2012 Estimate £m**	**31/03/2013 Estimate £m**
Capital Financing Requirement	170.2	183.8	191.6	197.0
Less: Existing Profile of Borrowing and Other Long Term Liabilities	(135.5)	(135.5)	(135.5)	(135.5)
Cumulative Maximum External Borrowing Requirement	34.7	48.3	56.1	61.5
Balances & Reserves	(55.9)	(40.9)	(43.7)	(34.6)
Cumulative Net Borrowing Requirement/Investments	**(21.2)**	**7.4**	**12.4**	**26.9**

4.5 The Council's strategy is 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. 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.

4.6 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 identified in the Treasury Management Practices Schedules up to the available capacity within its CFR and Affordable Borrowing Limit (defined by CIPFA as the Authorised Limit).

The outlook for borrowing rates:

4.7 Short-dated gilt yields are forecast to be 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.

4.8 The differential between investment earnings and debt costs, despite long term borrowing rates being around historically low levels, remains acute and this is expected to remain a feature during 2010/11. The so-called "cost of carry" associated with long term borrowing compared to temporary investment returns means that the appetite for new long term borrowing brings with it additional short-term costs. It is not surprising that the use of internal resources in lieu of borrowing has been the most cost effective means of financing capital expenditure but, at some stage, internal resources will become depleted and require topping up.

4.9 PWLB variable rates have fallen 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. Against a backdrop of interest rates remaining lower for longer and a continuation of the cost of carry backdrop, then a passive borrowing strategy i.e. borrow long term funds as they are required may remain appropriate. Equally, variable rate funds (that avoid the cost of carry) or EIP (equal instalments of principal) that mitigate the impact are both active considerations.

4.10 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. When 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.

4.11 The PWLB remains the preferred source of borrowing given the transparency and control that its facilities continue to provide.

4.12 The Council has £17m loans which are LOBO loans (Lender's Options Borrower's Option) all of 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.

4.12 The Council will undertake a financial options appraisal process to establish how it has arrived at its 'value for money' judgement in the use of resources.

5. <u>Debt Rescheduling</u>

5.1 The Council will continue to maintain a flexible policy for debt rescheduling. Market volatility and the steep yield curve 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.

5.2 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 was 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.

5.3 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.

5.4 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).

5.5 Borrowing and debt rescheduling activity will be reported to the next Cabinet meeting.

6. Investment Policy and Strategy

Background

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

Investment Policy

6.2 To comply with the CLG's guidance, 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 CLG's recent (draft) revised Guidance on investments reiterates security and liquidity as the primary objectives of a prudent investment policy. The speculative procedure of borrowing purely in order to invest is unlawful.

6.3 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 Annex C.

6.4 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 6.12. 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.

6.5 The CLG's Draft revisions to its Guidance on local government investments recommend that the strategy should state the authority's policies on investing money borrowed in advance of spending needs. This statement should identify any measures to minimise such investments, including any limits on:

- amounts borrowed and
- periods between borrowing and expenditure.

The statement should also comment on the management of risks, including the risk of loss of the borrowed capital and the risk associated with interest rate changes.

Limits on the amount borrowed in advance of need are identified in the Cumulative Maximum External Borrowing Requirement for future financial years set out in the table at paragraph 4.4. This also sets the periods between borrowing and expenditure. The management of risks, including the risk of loss of the borrowed capital are identical to all forms of investment as set out in this strategy. The risk associated with interest rate changes are based on the Interest Rate forecast at Annex B and the current cost of carry referred to in section 4 above.

Investment Strategy

6.6 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 a key support in the Council's budget.

6.7 The UK Bank Rate has been maintained at 0.5% since March 2009. **Short-term money market rates are likely to remain at 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.

6.8 The Borough Treasurer and Head of Assets, 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 Cabinet meeting.

Investments managed in-house:

6.9 The Council's shorter term cash flow investments are made with reference to the outlook for the UK Bank Rate and money market rates.

6.10 In any period of significant stress in the markets, the default position is for investments to be made with the Debt Management Office.

6.11 Currently the Council has restricted its investment activity to:

- 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 (CNAV)
- 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)**
- Bonds issued by Multilateral Development Banks

Please see Annex C for a breakdown of current counterparties, instruments and limits used.

**Eligible Institutions can issue new guaranteed debt under the CGS until 28/02/2010, after which only existing guaranteed debt can be rolled over.*

6.12 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 (see Annex C/D), 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 Annex C.

6.13 To protect against a prolonged period of low interest rates, 1-year deposits and longer-term secure investments will be actively considered within the limits the Council has set for Non-Specified Investments (see Annex D). The longer-term investments will be likely to 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 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. (*Please note that these bonds would, under existing statute, be capital expenditure investments*.)

Investments managed externally

Funds managed on a segregated basis

6.14 The Council's funds are also managed on a discretionary basis by Investec. The fund's remit allows the managers scope to add value through the use of investments contained in Annex C and within the parameters and guidelines set for the Council's fund. Performance is monitored and measured against the benchmark set for the fund, prevailing economic conditions and investment opportunities. External investment managers are contractually required to comply with the Investment Strategy.

6.15 The fund manager's expectation on the range of returns is based on their economic outlook and their forecasts for gilt/bond yields and money market rates.

Collective Investment Schemes (Pooled Funds):

6.16 The Council has evaluated the use of Pooled Funds and determined the appropriateness of their use within the investment portfolio. Pooled funds enable the Council to diversify the assets and the underlying risk in the investment portfolio and provide the potential for enhanced returns.

6.17 Investments in pooled funds will be undertaken with advice from Arlingclose. The Council does not currently have investments in a Pooled Fund although this is currently being considered. The performance and continued suitability of these funds in meeting the Council's investment objectives are regularly monitored.

7. Balanced Budget Requirement

7.1 The Council complies with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget.

2010/11 MRP Statement

8.1 The Local Authorities (Capital Finance and Accounting)(England)(Amendment) Regulations 2008 (SI 2008/414) place a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Secretary of State and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

8.2 The four MRP options available are:
Option 1: Regulatory Method
Option 2: CFR Method
Option 3: Asset Life Method
Option 4: Depreciation Method

NB This does not preclude other prudent methods.

The 2009 SORP and IFRS may result in PFI schemes and leases being brought on balance sheet. Where this is the case the CFR will increase, which will lead to an increase in the MRP charge to revenue. MRP for these items will match the annual principal repayment for the associated deferred liability.

8.3 MRP in 2010/11: Options 1 and 2 may be used only for supported expenditure. Methods of making prudent provision for self financed expenditure include Options 3 and 4 (which may also be used for supported expenditure if the Council chooses).

8.4 The MRP Statement will be submitted to Council before the start of the 2010/11 financial year. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement should be put to Council at that time.

8.5 The Council will apply Option 2 in respect of supported capital expenditure and Option 3/Option 4 in respect of unsupported capital expenditure.

9. <u>Reporting on the Treasury Outturn</u>

The Borough Treasurer & Head of Assets will report to the Cabinet on treasury management activity / performance as follows:
(a) Quarterly against the strategy approved for the year.
(b) The Council will produce an outturn report on its treasury activity no later than 30th September after the financial year end.
(c) The Cabinet will be responsible for the scrutiny of treasury management activity and practices.

10. <u>Other items</u>

Training

CIPFA's revised Code requires the *responsible officer* to ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

The CLG's Draft revisions to its Guidance on local government investments recommend that the Investment Strategy should state what process is adopted for reviewing and addressing the needs of the authority's treasury management staff for training in investment management.

Treasury management staff will have regular access to training opportunities to ensure they are fully up-to-date with developments. This will be delivered by a combination of workshops provided by Arlingclose and CIPFA technical updates.

Treasury management for those members charged with governance will also be arranged during the 2010/11 financial year.

Investment Consultants

The CLG's Draft revisions to its Guidance on local government investments recommend that the Investment Strategy should state:

- Whether and, if so, how the authority uses external contractors offering information, advice or assistance relating to investment and

- How the quality of any such service is controlled.

Cheshire East BC has appointed Arlingclose Ltd to advise on investments following a joint tender exercise carried out with Cheshire West and Chester Council. The Council expects to be kept regularly informed on any changes in opinion on potential counterparties with immediate notification of potential problems with any counterparties. A regular review is carried out by Arlingclose on all aspects of Cheshire East's investment activities.

Publication

The CLG's Draft revisions to its Guidance on local government investments recommend that the initial strategy and any revised strategy should, when approved, be made available to the public free of charge, in print or online.

Once approved the Treasury Management Strategy will be made available for public access on the Councils internet site.

ANNEX A

PRUDENTIAL INDICATORS 2010/11 TO 2012/13

1 Background:

There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators. It should be noted that CIPFA undertook a review of the Code in early 2008, and issued a revised Code in November 2009.

2. Net Borrowing and the Capital Financing Requirement:

This is a key indicator of prudence. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that the net external borrowing does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

The Borough Treasurer & Head of Assets reports that the authority had no difficulty meeting this requirement in 2009/10, nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

3. Estimates of Capital Expenditure:

3.1 This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax.

No. 1	Capital Expenditure	2009/10 Approved £m	2009/10 Revised £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
	Total	**97**	**105**	**103**	**29**	**15**

3.2 Capital expenditure will be financed as follows:

Capital Financing	2009/10 Approved £m	2009/10 Revised £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
Capital receipts	15	16	24	4	4
Government Grants	44	54	52	20	10
External Contributions	7	6	1	0	0
Revenue contributions	3	4	4	0	0
Supported borrowing	14	12	16	4	1
Unsupported borrowing	14	13	6	1	0
Total	**97**	**105**	**103**	**29**	**15**

Note: the element to be financed from borrowing impacts on the movement in the Capital Financing Requirement.

4. Ratio of Financing Costs to Net Revenue Stream:

4.1 This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet borrowing costs. The definition of financing costs is set out at paragraph 87 of the Prudential Code.

4.2 The ratio is based on costs net of investment income.

No. 2	Ratio of Financing Costs to Net Revenue Stream	2009/10 Approved	2009/10 Revised	2010/11 Estimate	2011/12 Estimate	2012/13 Estimate
	Total	**5.26%**	**5.35%**	**5.64%**	**6.32%**	**6.59%**

5. Capital Financing Requirement:

5.1 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and its financing. It is an aggregation of the amounts shown for Fixed and Intangible assets, the Revaluation Reserve, the Capital Adjustment Account, Government Grants Deferred and any other balances treated as capital expenditure**.

No. 3	Capital Financing Requirement	2009/10 Approved £m	2009/10 Revised £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
	Total CFR	**153**	**170**	**184**	**192**	**197**

*** in line with CIPFA's guidance, any investments or other items not falling within the classification of fixed or intangible assets, but financed from capital resources must be included within the CFR for the purposes of this calculation.*

5.2 The year–on-year change in the CFR is due to the following

Capital Financing Requirement	2009/10 Approved £m	2009/10 Revised £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
Balance B/F	**153**	**151**	**170**	**184**	**192**
Capital expenditure financed from borrowing (per 3.2)		25	22	17	15
Revenue provision for debt Redemption.		-6	-8	-9	-10
Other items: *(specify)*					
Deferred Liability Add : PFI brought on B/S Less : PFI Principal Repayment	 - -	 - -	 - -	 - -	 - -
Deferred Liability +Operating Lease brought on B/S -Operating Lease Principal Repayment	 - -	 - -	 - -	 - -	 - -
Balance C/F	**153**	**170**	**184**	**192**	**197**

6. Actual External Debt:

6.1 This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

No. 4	Actual External Debt as at 31/03/2009	£m
	Borrowing	136
	Other Long-term Liabilities	-
	Total	**136**

7. Incremental Impact of Capital Investment Decisions:

7.1 This is an indicator of affordability that shows the impact of capital investment decisions on Council. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

No. 5	Incremental Impact of Capital Investment Decisions	2009/10 Approved £	2010/11 Estimate £	2011/12 Estimate £	2012/13 Estimate £
	Increase in Band D Council Tax	3.10	3.27	8.31	11.53

8. Authorised Limit and Operational Boundary for External Debt:

8.1 The Council has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy and practice. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Council and not just those arising from capital spending reflected in the CFR.

8.2 The **Authorised Limit** sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities. This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Council's existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.

8.3 The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.

8.4 The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

No. 6	Authorised Limit for External Debt	2009/10 Approved £m	2009/10 Revised £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
	Borrowing	218	180	195	210	225
	Other Long-term Liabilities	-	-	-	-	-
	Total	**218**	**180**	**195**	**210**	**225**

8.5 The **Operational Boundary** links directly to the Council's estimates of the CFR and estimates of other cashflow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

8.6 The Borough Treasurer & head of Assets has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the next meeting of the Council.

No. 7	Operational Boundary for External Debt	2009/10 Approved £m	2009/10 Revised £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
	Borrowing	210	170	185	200	215
	Other Long-term Liabilities	-	-	-	-	-
	Total	**210**	**170**	**185**	**200**	**215**

9. Adoption of the CIPFA Treasury Management Code:

9.1 This indicator demonstrates that the Council has adopted the principles of best practice.

No. 8	Adoption of the CIPFA Code of Practice in Treasury Management
	The Council approved the adoption of the CIPFA Treasury Management Code at its Shadow Council meeting on 24 February 2009

The Council has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices.

10. Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure:

10.1 These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. This Council calculates these limits on net principal outstanding sums, (i.e. fixed rate debt net of fixed rate investments).

10.2 The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises which could adversely impact on the revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments

		2009/10 Approved %	2009/10 Revised %	2010/11 Estimate %	2011/12 Estimate %	2012/13 Estimate %
No. 9	**Upper Limit for Fixed Interest Rate Exposure**	100	100	100	100	100
No. 10	**Upper Limit for Variable Interest Rate Exposure**	100	100	100	100	100

10.3 The limits above provide the necessary flexibility within which decisions will be made for drawing down new loans on a fixed or variable rate basis; the decisions will ultimately be determined by expectations of anticipated interest rate movements as set out in the Council's treasury management strategy.

11. Maturity Structure of Fixed Rate borrowing:

11.1 This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

11.2 It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

No. 11	Maturity structure of fixed rate borrowing	Lower Limit %	Upper Limit %
	under 12 months	0	25%
	12 months and within 24 months	0	25%
	24 months and within 5 years	0	35%
	5 years and within 10 years	0	35%
	10 years and within 20 years	0	100%
	20 years and within 30 years	0	100%
	30 years and within 40 years	0	100%
	40 years and within 50 years	0	100%
	50 years and above	0	100%

12. Upper Limit for total principal sums invested over 364 days:

12.1 The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested.

No. 12	Upper Limit for total principal sums invested over 364 days	2009/10 Approved %	2009/10 Revised £m	2010/11 Estimate £m	2011/12 Estimate £m	2012/13 Estimate £m
		40%	**20.0**	**20.0**	**20.0**	**20.0**

Note: Original approved limit expressed as a % of total investments. Revised and future estimates stated as maximum value.

Arlingclose's Economic and Interest Rate Forecast

	Mar-10	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**	**0.50**	**1.00**	**1.50**	**2.00**	**2.50**	**3.00**	**3.00**	**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
1-yr LIBID													
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**	**1.25**	**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
5-yr gilt													
Upside risk	+0.25	+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	**2.70**	**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	-0.25
10-yr gilt													
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	**3.75**	**3.75**	**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
20-yr gilt													
Upside risk	+0.25	+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	**4.25**	**4.50**	**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	-0.25
50-yr gilt													
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	+0.50
Central case	**4.25**	**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 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 have been compressed by Quantitative Easing and will rise once QE tapers off and if government debt remains at record high levels.
- The path of the base rate has been downgraded to reflect the fragile state of the recovering economy and the severe fiscal correction that will be coming post General Election that will dampen aggregate demand and cut household cash flow. 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.

Assumptions

- The Bank of England has signalled an end to **Quantitative Easing** (QE) which injected £200bn to insure against the downside risks to growth and stimulate the economy. We estimate that QE has depressed gilt yields by around 70bs (0.7%)

- The Bank forecasts **GDP** to grow by 4% in 2011 but concedes growth could be impeded by corporate and consumer balance sheet adjustments, restrictions in bank credit and consumers' cautious spending behaviour. This is an optimistic forecast in our view; evidence of recovery is scant with weak real economic data and rising unemployment. Q4 2009 grew by just 0.1%.

- Looming bank regulation and liquidity and capital requirements will curb banking 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.

- 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.
- **Inflation** is not an immediate worry for the Bank's which forecasts CPI to rise due to higher commodity prices and VAT reverting to 17.5%. Commodity prices and VAT will push inflation over 3% prompting a letter from the Bank's Governor to the Chancellor in Q1 2010.
- The **UK fiscal deficit** remains acute. Cuts in public spending and tax increases are now inevitable and more likely to be pushed through in 2010 by a new government with a clear majority, however a hung parliament cannot be ruled out and would be potentially disruptive to financial markets.
- The net supply of gilts will rise to unprecedented levels in 2010. Failure to articulate and deliver on an urgent and credible plan to lower government borrowing to sustainable levels over the medium term will be negative for gilts.
- The Federal Reserve Chairman Bernanke's diagnosis of a weak U.S. economy and labour market signal that the Fed's "extended period" of low rates may get even longer. The outlook for the Eurozone is more optimistic but the European Central Bank will only increase rates after a durable upturn in growth.

ANNEX C

Specified and Non Specified Investments

Please note the CLG is in the process of undertaking a review of the Investment Guidance for Local Authorities in England and this section would therefore be subject to review and amendment

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 criteria as determined by the Council or is made with the UK government or is made with a local authority in England, Wales and Scotland.
- 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.

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.

New specified investments will be made within the following limits:

Instrument	Country	Counterparty	Maximum Limit of Investments %/£m
Term Deposits	UK	DMADF, DMO	No limit
Term Deposits/Call Accounts	UK	Other UK Local Authorities	No limit
Term Deposits/Call Accounts	UK	Abbey (Santander (UK))	25% up to £20m
Term Deposits/Call Accounts	UK	Bank of Scotland/Lloyds	25% up to £20m
Term Deposits/Call Accounts	UK	Barclays	25% up to £20m
Term Deposits/Call Accounts	UK	Clydesdale (inc Yorkshire Bank)	25% up to £20m
Call Accounts	UK	Co-Operative Bank	25% up to £10m
Term Deposits/Call Accounts	UK	HSBC	25% up to £20m
Term Deposits/Call Accounts	UK	Nationwide Building Society	25% up to £20m
Term Deposits/Call Accounts	UK	Royal Bank of Scotland	25% up to £20m
Term Deposits/Call Accounts	Australia	Australia and NZ Banking Group	15% up to £15m
Term Deposits/Call Accounts	Australia	Commonwealth Bank of Australia	15% up to £15m
Term Deposits/Call Accounts	Australia	National Australia Bank Ltd	15% up to £15m
Term Deposits/Call Accounts	Australia	Westpac Banking Corp	15% up to £15m
Term Deposits/Call Accounts	Canada	Bank of Montreal	15% up to £15m
Term Deposits/Call Accounts	Canada	Bank of Nova Scotia	15% up to £15m
Term Deposits/Call Accounts	Canada	Canadian Imperial Bank of Commerce	15% up to £15m
Term Deposits/Call Accounts	Canada	Royal Bank of Canada	15% up to £15m
Term Deposits/Call Accounts	Canada	Toronto-Dominion Bank	15% up to £15m

Term Deposits/Call Accounts	Finland	Nordea Bank Finland	15% up to £15m
Term Deposits/Call Accounts	France	BNP Paribas	15% up to £15m
Term Deposits/Call Accounts	France	Calyon (Credit Agricole Group)	15% up to £15m
Term Deposits/Call Accounts	France	Credit Agricole SA	15% up to £15m
Term Deposits/Call Accounts	Germany	Deutsche Bank AG	15% up to £15m
Term Deposits/Call Accounts	Netherlands	Rabobank	15% up to £15m
Term Deposits/Call Accounts	Spain	Banco Bilbao Vizcaya Argentaria	15% up to £15m
Term Deposits/Call Accounts	Spain	Banco Santander SA	15% up to £15m
Term Deposits/Call Accounts	Switzerland	Credit Suisse	15% up to £15m
Term Deposits/Call Accounts	US	JP Morgan	15% up to £15m
Gilts	UK	DMO	No limit
Bonds	EU	European Investment Bank/Council of Europe	25% up to £20m
AAA rated Money Market Funds	UK/Ireland/ Luxembourg	CNAV MMFs	25% up to £20m per fund Limit of 50% in all funds
Other MMFs and CIS	UK	Collective Investment Schemes	25% up to £20m

A limit of 40% of total investments to apply to investments in non-UK banks at any one time with a limit of 25% of total investments in any one non-UK country.

Where practical any investments in Money Market Funds should be spread between at least two funds.

NB Any existing deposits outside of the current criteria will be reinvested with the above criteria on maturity.

Non-Specified Investments determined for use by the Council

Having considered the rationale and risk associated with Non-Specified Investments, the following have been determined for the Council's use:

	In-house use	Use by fund managers	Maximum maturity	Max % of portfolio	Capital expenditure?
▪ Deposits with banks and building societies ▪ Certificates of deposit with banks and building societies	✓ ✓	 ✓	5 yrs	25% in aggregate	No
Gilts and bonds ▪ Gilts ▪ Bonds issued by multilateral development banks ▪ Bonds issued by financial institutions guaranteed by the UK government, e.g. GEFCO ▪ Sterling denominated bonds by non-UK sovereign governments	✓ (on advice from treasury advisor)	✓	10 years	75% in aggregate	No
Money Market Funds and Collective Investment Schemes (pooled funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573) but which are not credit rated	✓ (on advice from treasury advisor)	✓	These funds do not have a defined maturity date	50%	No
Government guaranteed bonds and debt instruments (e.g.	✓	✓	10 years	£20m	**Yes**

floating rate notes) issued by corporate bodies (e.g. govt bonds issued by HBOS / RBS / Nationwide, etc)					
Non-guaranteed bonds and debt instruments (e.g. floating rate notes) issued by corporate bodies	✓	✓	10 years	£20m	**Yes**
Collective Investment Schemes (Pooled funds) which do not meet the definition of collective investment schemes in SI 2004 No 534 or SI 2007 No 573	✓ (on advice from treasury advisor)	✓	These funds do not have a defined maturity date	£20m	**Yes**

1. In determining the period to maturity of an investment, the investment should be regarded as commencing on the date of the commitment of the investment rather than the date on which funds are paid over to the counterparty.
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.
3. Where investments are made in banks for periods of greater than one year then the following minimum ratings will apply to the counterparty:

	Long-term	**Short-term**
Fitch	AA- (AA minus)	F1+
Moody's	Aa3	P-1
S&P	AA- (AA minus)	A-1+