Chorley Council

Report of	Meeting	Date
Statutory Finance Officer	Special Council	2 March 2010

Treasury Strategies and Prudential Indicators 2010/11 to 2012/13

PURPOSE OF REPORT

1. To set prudential indicators for the years to 2012/13, and to recommend criteria to be followed in treasury operations in 2010/11.

RECOMMENDATION(S)

2. That the Council approve the following:

   - The Prudential Indicators for 2010/11 to 2012/13
   - The Treasury Management Strategy for 2010/11, incorporating the Treasury Prudential Indicators
   - The Annual Investment Strategy 2010/11
   - The Annual MRP Policy Statement 2010/11

3. That the Council adopt the updated CIPFA Code of Practice for Treasury management in the Public Services and the Treasury Management Policy Statement.

4. That the proposed amendments to the Council's Financial Procedure Rules, detailed at Appendix C3, be recommended for adoption by the Council.

EXECUTIVE SUMMARY OF REPORT

5. This report outlines the Council's prudential Indicators for 2010/11 to 2012/13, and sets out the expected treasury operations for this period. It also states the policy for making the minimum provision for repayment of debt. It should be considered together with the Council's Financial Strategy, budget and Council Tax proposals for 2010/11.

REASONS FOR RECOMMENDATION(S)

(If the recommendations are accepted)

6. It is a statutory requirement that Councils approve the policies, indicators and statements addressed in this report prior to the commencement of each financial year.

ALTERNATIVE OPTIONS CONSIDERED AND REJECTED

7. None

CORPORATE PRIORITIES

8. This report relates to the following Strategic Objectives:

Put Chorley at the heart of regional economic development in the Central Lancashire sub-region		Develop local solutions to climate change.	
Improving equality of opportunity and life chances		Develop the Character and feel of Chorley as a good place to live	
Involving people in their communities		Ensure Chorley Borough Council is a performing organization	✓

BACKGROUND

9. The Local Government Act 2003, has given authorities greater discretion over capital expenditure through prudential borrowing, made compliance with CIPFA's Prudential Code, and CIPFA's Treasury Management Guidance, statutory requirements. The former requires the production of Indicators showing that expenditure is affordable, the latter requires the approval of an annual Treasury Management Strategy incorporating Treasury Indicators and limits.

10. Consequential to the Prudential Borrowing powers is a requirement that authorities should make prudential provision for the repayment of borrowing (MRP). This is to be the subject of an annual policy statement to be made to the full Council prior to the start of each year.

11. Finally Authorities have, through the Local Government Act 2003, also been given greater discretion in investing surplus cash. They are required however, by guidance issued by the CLG, to prepare an annual Investment Strategy to identify how that discretion should be applied.

12. This report therefore brings together these related requirements by submitting, for the approval of Council, the four statements.

DETAIL

13. The detailed statements and strategies etc are attached

IMPLICATIONS OF REPORT

14. This report affects the following areas. The relevant Directors' comments are attached:

Finance	✓	Customer Services	
Human Resources		Equality and Diversity	
Legal	✓	No significant implications in this area	

COMMENTS OF THE STATUTORY FINANCE OFFICER

15. This report meets statutory requirements. Its statistical content is consistent with the assumptions made in the revenue budget. The criteria it recommends will direct the Council's treasury operations in 2010/11.

GARY HALL
STATUTORY FINANCE OFFICER

Document	Inspection
Financial Strategy/Budget and Council Tax 2010/11 Treasury Management in the Public Services: Code of Practice CIPFA Prudential Code for Capital Finance in Local Authorities Treasury Management Report to Governance Committee 22/9/09	Town Hall

Report Author	Ext	Date	Doc ID
G Whitehead	5485	12/02/10	Treasury Strategy

PRUDENTIAL INDICATORS 2010/11 to 2012/13

Local Authorities have discretion to incur capital expenditure in excess of the capital resources provided by government, or those resources resulting from the sale of assets or the receipt of contributions from other parties.

To manage that process the Council must consider the following Indicators. These are designed to indicate that the expenditure is prudent and affordable.

Prudential Indicator 1 - Capital Expenditure

The following statement summarises the Capital Programme. It shows a reliance on prudential borrowing is intended. Provision for this has been built into the revenue budget.

Capital Expenditure	2009/10 Revised £'000	2010/11 Estimate £'000	2011/12 Estimate £'000	2012/13 Estimate £'000
The Council's capital expend.	6,520	8,640	1,935	1,461
Less Capital resources				
capital receipts	(690)	(517)	(100)	(100)
contributions	(1,579)	(5,047	(849)	
Grants	(1,004)	(1,299)	(480)	(480)
Revenue and reserves	(583)	(1,164)	0	(266)
Balance – new prudential borrowing	2,664	613	506	615

Prudential Indicator 2 - Capital Financing Requirement (CFR)

The CFR is a measure of the capital expenditure of the Council which is still to be paid for. Such expenditure is temporarily met by borrowing, by leasing or by reducing the Council's other cash balances. Ultimately however it has to be paid for and will be a charge to Council tax payers.

	2009/10 Revised £'000	2010/11 Estimate £'000	2011/12 Estimate £'000	2012/13 Estimate £'000
Estimated CFR at period end	9,823	9,979	9,985	10,100
Annual change in CFR	2,435	156	6	115
This consists of prudential borrowing in year		613	506	615
Less estimated MRP		(457)	(500)	(500)

The increases in the CFR shown in the above table are caused by the new prudential borrowing (as above), less the provision made in the Council's budget for debt repayment (MRP).

Prudential Indicator 3 – Ratio of financing costs to the net revenue stream

This indicator shows the proportion of the Council's budget (i.e. the costs it has to meet from government grants and local taxpayers), that is required to meet the costs associated with borrowing (interest and principal, net of interest received).

	2009/10 Revised %	2010/11 Estimate %	2011/12 Estimate %	2012/13 Estimate %
Ratio	2.30	3.93	5.46	5.54

Prudential Indicator 4 – Incremental impact of capital investment decisions on the band D Council Tax

This shows the cumulative effect on Council tax levels of the capital programme plans of the Council.

	2010/11 Estimate £	2011/12 Estimate £	2012/13 Estimate £
Increase in Band D charge	3.49	4.91	6.87

TREASURY MANAGEMENT STRATEGY 2010/11

The treasury management service fulfils an important role in the overall financial management of the Council's affairs. Whilst the prudential indicators shed light on the affordability and consequence of capital expenditure plans, the treasury service deals with any consequential borrowings, and the management of cash balances.

1. Changes in 2009/10

The Council has a statutory obligation to have regard to the CIPFA Code of Practice, and is required to adopt both the Code and the Treasury Management Policy Statement therein. Both of these have previously been adopted by the Council, but both have been revised in 2009. The main changes in the new Code and the Policy Statement are:

- The priority of security and liquidity is emphasised
- There are Increased reporting requirements
- The responsibilities of the Audit Committee for scrutiny, and the personal responsibility of members to ensure they have appropriate skills and training.
- Spotlighting of the risk in borrowing ahead of need
- Revision to the advice on Counterparty selection criteria
- Revised advice on money laundering

Steps have already been taken to comply with these requirements, and this report incorporates further proposals. Specific steps will be taken in the coming year to provide the necessary training to members.

<u>Prudential Indicator 5 – Adoption of the CIPFA Code of Practice for Treasury Management in the Public Services</u>

The Council is recommended to adopt the updated CIPFA publication *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes*.

<u>Prudential Indicator 6 – Adoption of the Treasury Management Policy Statement</u>

The Council is recommended to adopt as part of its Financial Regulations, the updated clauses shown in Appendix C1. These concern the regulation of internal processes, reporting requirements and officer and committee responsibilities

2. Reporting

This strategy statement has been prepared in accordance with the revised code, for approval by the Council. The Code requires, as a minimum, a further mid year monitoring report, and a final report on actual activity after the year end. It is intended however to submit additional monitoring reports to the Audit Committee during the year.

3. Borrowing and Investment Projections

The Council's borrowings and investment are inter-related. The following table details the expected changes in borrowings, consistent with the capital and revenue budgets, and the balances available for investment at each year end.

	2009/10 Revised £'000	2010/11 Estimate £'000	2011/12 Estimate £'000	2012/13 Estimate £'000
Borrowing at period start	4,633	2,266	9,400	9,300
Borrowing repaid in year	(2,367)	(1,366)	(700)	(200)
Estimated borrowing in year		8,500	600	0
Est. borrowing at period end	2,266	9,400	9,300	9,100
Est. investments at period end	Nil	Nil	Nil	(200)
Net Borrowing	2,266	9,400	9,300	8,900

It will be seen that over the years to 2012/13 there is considerable movement in the Council's borrowings, current short term loans being repaid, new replacement loans being made. Over the four year period there is an increase of £4.5m.

This increase is necessary:

- To make good borrowings repaid in 2008/09 and
- To fund the prudential borrowings over this period of £2.7m.

It is important to note that the timing of borrowing does not determine the timing of the charge, in the Council's accounts for the repayment of debt (MRP). The MRP provision commences in the year capital expenditure is incurred, not when borrowing is made.

Prudential Indicator 7

The Prudential Code requires authorities to make comparison between net borrowing and the CFR. At its greatest net borrowing should not exceed the current years CFR plus the estimated increases in CFR for the following two years. The figures reported above meet this requirement.

Prudential Indicator 8 – Operational Boundary for External Debt

This is the probable, expected limit on external debt. "Debt" consists of both borrowings and any other long term liabilities, although in Chorley these are so small (£14k) that they have been ignored in setting the limit.

The expected borrowings at year end are as shown in the table below:

	31/3/10 Revised £'000	31/3/11 Estimate £'000	31/3/12 Estimate £'000	31/3/13 Estimate £'000
Expected borrowings	3,500	9,400	9,300	9,100
Other long term liabilities	0	0	0	0
Operational boundary	3,500	9,400	9,300	9,100

The introduction of International Accounting Standards will cause further leases to be reclassified which might affect these limits.

Prudential Indicator 9 - Authorised Limit for External Debt

In the following table the limit has been based on the Capital Financing Requirement (PI 2) since this is a measure of the need for debt.

	31/3/10 Revised £'000	31/3/11 Estimate £'000	31/3/12 Estimate £'000	31/3/13 Estimate £'000
Borrowings	4,000	9,979	9,985	10,100
Other long term liabilities	0	0	0	0
Authorised limit	4,000	9,979	9,985	10,100

4. Economic outlook and expected movement in interest rates

The advice of the Council's consultants is attached at Appendix C2. In summary it describes two completely different views of the economic landscape over the next two years.

- EITHER a strong UK recovery will occur fuelled by a weakened pound, strong exports, and a continuing recovery in house prices. Inflation will fall back, bank rate will rise to 3%, and long term rates as high as 5.5% (10 years) to 6% (50 years) on the back of the high levels of government borrowing.

- OR a weak UK recovery resulting from ongoing shortages of credit from weakened banks, reversal of quantitative easing taking money out of the economy, rising unemployment, depressed consumer demand, and public sector spending cuts and tax rises. Bank rate will remain at 0.5% throughout 2010/11 and the following year, and long term rates will fall back to 3.15% (10 years) to 4.25% (50 years).

The Sector view anticipates moderate growth, but with a balance of risk to the downside. With regard to interest rates it envisages bank rate rising to 1.5% by March 2011 and 3.5% twelve months later. The risk is that longer term borrowing costs will be driven higher by the levels of government borrowing.

5. Borrowing strategy

The borrowing strategy of the Council has to consider three issues:

- The need, and amount, to borrow
- The timing of borrowing
- The period of borrowing

<u>Need to Borrow</u>

Normally the Council has a net inflow of cash in the first three quarters of the year. This might allow the additional borrowing of an estimated £8.5m to be deferred, in part or in total, until the last quarter. The instinctive plan is not to borrow until the cash is needed, since holding cash in advance of need will incur a cost. This judgement will however be affected by anticipated movements in interest rates.

<u>Interest rate movements and the timing of borrowing</u>

As discussed in paragraph 4 there are different views about interest rate movements. The Sector view is that rates across all periods will increase throughout the year by roughly 0.5%. This would add £42k pa to the cost of borrowing £8.5m. The timing will thus be based on a judgement as to whether the advantage of early borrowing (possible lower rate) is outweighed by the carrying cost (the difference between the cost of the borrowing and the interest it earns prior to it being used).

Period of borrowing

Borrowings can be made for any period up to 50 years. A view will have to be taken regarding the attractiveness of certainty (i.e. by borrowing for a longer period of 5 or 10 years), compared to cheaper, but more volatile short term debt.

6. Treasury Management Limits on Activity

The Authority is required to set the following Treasury Indicators. The purpose of these is to minimise the risk resulting from movements in interest rates.

Treasury Indicator 1 – Upper limit on Variable rate exposure

The Council is exposed to interest rate movements on its invested cash. This is predicted to be very low, but the timing of receipts means that from time to time a significant balance might be available. To accommodate this a limit of £10m is proposed for future years. For the current year the limit has been revised to £15m to cover the maximum invested cash during 2009/10.

	2009/10 Revised	2010/11 Estimate	2011/12 Estimate	2012/13 Estimate
Upper limit on variable rate exposure	£15m	£10m	£10m	£10m

Treasury Indicator 2 – Upper limit on fixed rate exposure

The Council is exposed to fixed rate interest on any long term liabilities and PWLB borrowings. The maximum estimated exposure is shown in the following table.

	2009/10 Revised	2010/11 Estimate	2011/12 Estimate	2012/13 Estimate
Upper limit on fixed rate exposure	£5.0m	£9.9m	£10.0m	£10m

Treasury Indicator 3 - Maturity structure of borrowing

The Council is required to determine upper and lower limits for the maturity structure of its debt. The following limits have been set to give maximum flexibility

	2010/11	
	Lower Limit	Upper Limit
Under 12 months	0%	100%
12 months to 2 years	0%	100%
2 to 5 years	0%	100%
5 to 10 years	0%	100%
10 years and above	0%	100%

Treasury Indicator 4 – Total principal sums invested for greater than 364 days

It is not planned to make any investments for periods over 364 days.

7. Use of Treasury Advisors

The Council currently use Sector as its treasury management consultant. Their contract expires in 2010 and a retendering exercise is underway.

Whilst the adviser supports the internal treasury function, under current market rules and the CIPFA Code, responsibility for treasury management cannot be delegated outside the Authority; therefore, decision making and responsibility remains with the Council.

8. Performance Indicators

Investments – the generally accepted indicator is 7-day LIBID (The London Interbank Bid rate). This is the rate that could be obtained by the “passive” deposit of money onto the money market. Active investment, in normal times, should outperform this. It is recommended that this be set as an indicator although the narrow range of counterparties will affect the ability to achieve this.

INVESTMENT STRATEGY 2010/11

1. Introduction

1.1 Under the Power in Section (15) (1) of the Local Government Act 2003 the CLG has issued Guidance on Local Government Investments in March 2004, and is currently consulting on a new version updated in light of the investigations into the Icelandic banking crisis. Each Authority is recommended to produce an annual strategy that sets out its policies to manage investments, giving priority to security and liquidity. This strategy follows the updated guidance.

1.2 The major element in the guidance is that authorities should distinguish between lower risk (specified investments), and other investments (non-specified). These terms are explained in more detail below.

1.3 The specific issues to be addressed in the Investment Strategy are as follows. This includes new matters proposed in the draft; these are marked (UPD) below:

- How "high" credit quality is to be determined
- How credit ratings are to be monitored
- To what extent risk assessment is based upon credit ratings and what other sources of information on credit risk are used (UPD)
- The procedures for determining which non specified investments might prudently be used
- Which categories of non-specified investments the Council may use
- The upper limits for the amounts which may be held in each category of non- specified investment and the overall total.
- The procedures to determine the maximum periods for which funds may be committed.
- What process is adopted for reviewing and addressing the needs of members and treasury management staff for training in investment management (UPD).
- The Authority's policies on investing money borrowed in advance of spending needs. The statement should identify measures to minimise such investments including limits on (a) amounts borrowed and (b) periods between borrowing and expenditure (UPD)

2. Chorley Strategy 2010/11

Objectives

2.1The Council's investment priorities are:

- The security of capital and
- The liquidity of its investments.

2.2 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

2.3 The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity. The Council will restrict borrowing to a maximum of that envisaged to be required in the following eighteen months.

Use of Specified and Non-Specified Investments

2.4 Specified investments are those made~~:~~

- with high "quality" institutions, the UK Government or a local authority,
- for periods of less than one year and
- denominated in sterling.

Other investments are “non-specified”. These could include investments in gilts, bond issues by other sovereign bodies and those issued by multilateral development banks, commercial paper, and any deposits for a period exceeding one year.

In 2010 the Council will restrict its investments to those which are specified.

Counterparty Selection Criteria

2.5 A specified investment is defined as one with a high quality institution. In determining which institutions are “high” quality the Council will rely on the credit rating service of Sector, its current treasury advisor. This utilises the following information

- credit ratings of the three main agencies
- credit watches and outlooks, also provided by the agencies.
- Credit Default Swap spreads –The “spread” is the charge levied by one institution against another for providing what is in essence insurance against the risk that a loan might be subject to certain events (including default). It is an indicator of the markets perception of the credit standing of an institution.
- The sovereign rating of the country in which an institution is based.
- Whether an institution is nationalised or partly nationalised

It results in institutions being colour coded. The colour coding is used to determine the maximum amount and duration of any investment in those institutions.

2.6 The Council may use AAA rated Money Market Funds

2.7 The Council may lend to the UK Government (which includes the Debt Management Office)

2.8 The Council may lend to other Local Authorities

The current list of counterparties falling within this criteria is attached.

Monitoring of Credit ratings

2.9 Credit Ratings are monitored daily and email alerts are received if a rating changes or an institution is put on ratings watch

Time and money Limits

2.10 Currently the maximum amount that can be placed with a financial institution is £1m. This limit applies to the total of all deposits (in call accounts, in deposit accounts or on short term deposit). However, to allow some flexibility in exceptional circumstances, the £1m limit may be increased to £2m.

2.11 It is recommended that the limit on call accounts (Tier 6) be increased to £2m, This increase is proposed on the grounds that these accounts allow instant access, and the institutions used are, by definition, those with the least credit risk.

2.12 The current time limits are shown in the attached table. No change is recommended

Member Training

2.13 The increased Member consideration of treasury management matters and the need to ensure officers dealing with treasury management are trained and kept up to date, requires a suitable training process for members and officers. The Council will address this by .arranging training through its treasury management consultants.

Current list of Financial Institutions and Investment Criteria

Invest-ment Group	Category	Institutions	Sector colour code	Sovereign rating	Max period	Limit per Institution
Tier 1	Sovereign or Sovereign "type"	DMADF Local Authority UK Govt backed Money market funds			6 months 1 year n/a instant access	No limit £1m Not used
Tier 2	UK Nationalised Institutions	None (N Rock deposits no longer guaranteed)				
Tier 3	Institutions guaranteed by other governments	None (Irish Banks are guaranteed but have been removed from Chorley's list)				
Tier 4A (nb2)	UK Partly nationalised institutions; with access to the Credit Guarantee Scheme	RBS group (inc Nat West) Lloyds Group (inc HBoS & Lloyds)	Blue Blue	AAA stable from all 3 agencies	1 year 1 year	£1m £1m
Tier 4B (nb2)	Independent UK Institutions with access to the Credit Guarantee Scheme	HSBC Santander Barclays, Nationwide	Orange Red Green Green	AAA stable from all 3 agencies	1 year 6 months 3 months	£1m £1m £1m
Tier 5	Money Market Funds	Standard Life Global liquidity MM Fund	Aaa/MR1+		instant access	£1m
Tier 6	Deposit/Call Accounts	Santander, Bank of Scotland, Nat West			Call accounts with instant access	£1m

Note - Under the Credit Guarantee Scheme certain "eligible institutions" have access to liquidity from HM Treasury if required.

Note - The Sector colour coding suggests the following time limits on investments
Green (3 months), Orange (6 months), Red (1 year), Purple (2 years), Blue (1 year)

The proposals in the Investment Strategy will not increase the list of institutions. If approved it will increase the amounts which can be placed in the call accounts (Tier 6).

ANNUAL STATEMENT OF MRP POLICY 2010/11

The Council implemented the new MRP guidance in 2008/9 and 2009/10 and will assess their MRP for 2010/11 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

The major proportion of the MRP for 2010/1l relates to debt incurred prior to 2008/9. MRP will continue to be charged on this at the rate of 4%, in accordance with option 1 of the guidance. There are some capital schemes since then which generate a further MRP liability (i.e. capital expenditure which is not financed by any grant or contribution e.g. vehicles). The MRP liability on this will be based on the estimated useful life of the asset, using the equal annual instalment method of calculation (option 3 of the guidance).

Estimated life periods will be determined under delegated powers with reference to the guidance. As some types of capital expenditure are not capable of being related to an individual asset, the MRP will be assessed on a basis which most reasonably reflects the anticipated period of benefit arising from the expenditure.

APPENDIX C1

Treasury Management Clauses to form part of Financial Regulations

1. This Council will create and maintain, as the cornerstones for effective treasury management:

    - A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities;
    - Suitable Treasury Management Practices (TMP's), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

    The contents of the Policy Statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the Code's key principles.

2. The Council will receive reports on its treasury management policies, practices and activities, including as a minimum, an annual strategy and plan in advance of the year, a mid year review and an annual report after its close, in the form prescribed in the TMP's.

3. The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Cabinet, and for the execution and administration of treasury management decisions to the Chief Finance Officer, who will act in accordance with the Council's policy statement and TMP's, and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

4. The Council nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

Note – The Policy Statement referred to in paragraph 1 above is as the model defined in the Code. It defines treasury management (as the management of investments and cash flows, banking, money market and capital market transactions, the control of risk and the optimising of performance consistent with those risks). It identifies risk management as the prime criteria for measuring performance. Finally it commits the organisation to employing performance measurement techniques.

Note – A full version of the relevant Financial Regulations and Financial Procedure Rules 4 is attached at Appendix C. The old wording requiring deletion is struck out and the new wording requiring insertion is underlined.

APPENDIX C2

The following is the advice of the Council's consultants - Sector

"Economic outlook and expected movement in interest rates

The interest rate forecast is as follows:

Year	Bank Rate	PWLB Rates %		
	%	5 year	10 year	25 year
2010/11	0.5-1.5	3.05-3.60	4.00-4.45	4.55-4.90
2011/12	1.5-3.5	3.60-4.60	4.45-5.00	4.90-5.20
2012/13	3.5-4.5	4.60-4.85	5.0-5.15-	5.20-5.35

Economic Background

4.1. Introduction

- The credit crunch storm of August 2007 eventually fed through to the near collapse of the world banking system in September 2008. This then pushed most of the major economies of the world into a very sharp recession in 2009 accompanied by a dearth of lending from banks anxious to rebuild their weakened balance sheets. Many governments were forced to recapitalise and rescue their major banks and central banks precipitately cut their central bank rates to 0.10 – 1.00% in order to counter the recession.
- The long awaited start of growth eventually came in quarter 3 2009 in the US and the EU. However, there was disappointment that the UK failed to emerge from recession in quarter 3.
- Inflation has plunged in most major economies and is currently not seen as being a problem for at least the next two years due to the large output gaps and high unemployment putting a lid on wage growth. In many countries there have been widespread pay freezes in 2009 and these are likely to be persistent for some time.
- Deflation could become a threat in some economies if they were to go into a significant double dip recession.
- Asian countries, especially China, are buoying world demand through their own stimulus measures.
- There still needs to be a radical world rebalancing of excess savings rates by cash rich Asian and oil based economies and excess consumption rates in Western economies if the world financial system is not to avoid a potential rerun of this major financial crisis in years to come.
- Most major economies have resorted to a huge expansion of fiscal stimulus packages in order to encourage a fast exit from recession. This, together with expenditure on direct support provided to ailing banks, has led to a drastic expansion in government debt levels which will take many years to eliminate and to restore the previous health of national finances.

4.2 Two growth scenarios

- The current big issue is 'how quickly will the major world economies recover?' There is a sharp division of opinion on this question as set out below, with a knock on effect on interest rates.

4.2.1 Strong recovery

- This is a normal cyclical recovery which will be strong in the major world economies. The US still has potential to add further fiscal stimulus in 2010 to ensure that strong recovery continues after the current round of stimulus measures end. Growth in the EU is likely to be strong in 2010 and not require such help.

The UK:

- GDP growth will almost get back to the long term average of about 2.5% in 2011 but is likely to peak in the first half of the year as inventory rebuilding and stimulus measures fade and fiscal contraction kicks in later in the year.
- The economy will rebalance with strong growth in exports and import substitution helped by strong recovery in the EU and the rest of the world.
- Sterling has depreciated by 25% since the peak in 2007 and is likely to stay weak.
- Consumer spending – only a mediocre recovery is expected due to a steady increase in the savings ratio from +5.6% in 2009 to about 8% in 2011 as consumers pay down debt or build cash balances. Consumer incomes will be held down by wage freezes and increases in taxation.
- House price recovery is expected to persist helped by a low Bank Rate for a prolonged period; the peak to trough fall in house prices is now expected to be no more than 20%. House prices to rise by about 6% in 2010, and 3% in 2011; mortgage approvals will rise back to the level of 75 - 80,000 per month needed to ensure a continuation of a trend of rising house prices.
- CPI inflation to peak @ 2.5% in early 2010 after the rise in VAT in January but then to fall to a trough near 1.5% in early 2011 and to stay below 2% for the rest of 2011.
- The current MPC attitude is one of hang on as long as possible before increasing Bank Rate. The aim of this would be to try to ensure that growth gets going at a decent rate and that Bank Rate gets back to 4 – 5% before the next recession and that all assets purchased through QE have been sold off by then. The first Bank Rate increase is expected in Q3 2009.
- If there is a change of Government in 2010 with a more aggressive fiscal approach then this could delay the timing of Bank Rate starting to go up.
- The fiscal deficit is 6.4% of GDP, about £90bn, which is expected to fall at £11bn p.a. over eight years at currently planned rates. This is similar to the peak deficit of 7% in 1990s which was remedied to a surplus of 1.6% in the space of 6 years helped by strong, steady economic growth of 3% p.a. supported by loose monetary policy that compensated for the fiscal squeeze.
- Gilt yields, especially longer term ones, are currently artificially low due to the Bank of England's Quantitative Easing operations. £200bn of gilts, commercial bonds and paper are being purchased under this scheme which has inflated prices and depressed yields. Once this campaign ends, yields will inevitably rise but will also rise due to the huge level of issuance of new gilts to finance the fiscal deficit. Long gilt yields are therefore forecast to reach 6% during 2011.
- Gilt yields could rise higher if there was a hung Parliament in 2010 or if the fiscal situation deteriorates further.
- The major risk to this scenario would be a lack of supply of bank credit. However, it is felt that the Bank of England is on alert to ensure that this does not happen and would continue various measures to assist the expansion of credit.

4.2.2 Weak recovery

- The current economic cycle is not a normal business cycle but a balance sheet driven cycle. Over borrowed banks, corporates and consumers are focused on shrinking their levels of borrowing to more viable and affordable levels and this balance sheet adjustment will take several years to be effected. Repayment of debt will therefore act as a major head wind to the required increase in demand in the economy. Consequently there will only be weak economic recovery over the next few years after the initial sharp inventory rebuilding rebound fades. GDP growth is forecast to reach only +1.5% in 2011.
- Fiscal contraction will further dampen economic recovery driven by a strong political agenda to accelerate cuts in expenditure and increases in taxation after the general election in 2010.
- The consumer savings ratio will rise so as to eliminate over borrowing and to insure against people losing their jobs during this downturn. This will depress consumer expenditure, the main driver of the UK economy.
- Growth will also be hampered by a reduced supply of credit from weakened banks compounded by weak demand for credit.
- The eventual reversal of Quantitative Easing will take cash out of the economy and reduce demand in the economy.
- Unemployment is likely to rise to near to 3m in 2010 and take years to subside due to weak growth. High unemployment will reduce tax income and increase expenditure on benefits and the costs of local authority services.
- Inflation will not be a threat for several years as the current 6% output gap will take until 2014 to be eliminated.
- However, deflation is a major danger for some years: the major falls in manufacturing prices over the last 12 -18 months have still to feed through to the economy and then to impact wage deflation.
- CPI inflation will blip up over 2% in early 2010 but will then be on a strong downward trend to about -1% in 2011.
- There is no need for the MPC to change Bank Rate from 0.5% in 2010 or 2011 and possibly for 5 years as they will need to counter the fiscal contraction which will dampen demand in the economy.
- Long PWLB rates will <u>FALL</u> from current levels to near 4% in 2010 due to weak economic recovery and minimal inflation so that the real rate of return (net of inflation) on long gilts is healthy at these low levels

4.2.3 Sector view

- Sector recognises that at the current time it is difficult to have confidence as to exactly how strong the UK economic recovery will prove to be. Both the above scenarios are founded on major assumptions and research which could or could not turn out to be correct.
- Sector has adopted a more moderate view between these two scenarios outlined above i.e. a moderate return to growth.
- We do, however, feel that the risks that long term gilt yields and PWLB rates will rise markedly are high.
- There are huge uncertainties in all forecasts due to the major difficulties of forecasting the following areas: -
  - degree of speed and severity of fiscal contraction after the general election
  - timing and amounts of the reversal of Quantitative Easing,
  - speed of recovery of banks' profitability and balance sheet imbalances
  - changes in the consumer savings ratio
  - rebalancing of the UK economy towards exporting and substituting imports
- The overall balance of risks is weighted to the downside i.e. the pace of economic growth disappoints and Bank Rate increases are delayed and / or lower
- There is an identifiable risk of a double dip recession and deleveraging creating a downward spiral of falling demand, falling jobs and falling prices and wages leading to deflation but this is considered to be a small risk and an extreme view at the current time on the basis of current evidence

APPENDIX C3

Revisions to Appendix 4 of the Financial regulations and Financial Procedure Rules

Treasury Management

Why is this important?

3.96 Many millions of pounds pass through the authority's books each year. This led to the establishment of codes of practice. These aim to provide assurances that the authority's money is properly managed in a way that balances risk with return, but with the overriding consideration being given to the security of the authority's capital sum.

Key controls

~~3.97 The Council has adopted the CIPFA publication *Treasury Management in the Public Services: Code of Practice (the Code).*~~

3.97 The Council has adopted the CIPFA publication *Treasury Management in the Public Services: Code of Practice (the Code).*

3.98 This organisation will create and maintain, as the cornerstones for effective treasury management:

- A treasury management policy statement, stating the policies objectives and approach to risk management of its treasury management activities
- Suitable treasury management practices (TMPs), setting out the manner in which the council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of this council. Such amendments will not result in the council materially deviating from the Code's key principles.

3.99 This council will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid year review and an annual report after its close, in the form prescribed in the TMPs.

3.100 This council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Executive Cabinet, and for the execution and administration of treasury management decisions to the Chief Finance Officer who will act in accordance with the Council's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's *Standard of Professional Practice on Treasury Management.*

3.101 This Council nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies

Responsibilities of chief finance officer – treasury management and banking

3.102 To arrange the borrowing and investments of the authority in such a manner as to comply with the CIPFA Code of Practice on Treasury Management and the authority's treasury management policy statement and strategy.

3.103 To report minimum of three times a year on treasury management activities to the executive.

3.104 To operate such bank accounts as are considered necessary – opening or closing any bank account shall require the approval of the chief finance officer.

Responsibilities of chief officers – treasury management and banking

3.105 To follow the instructions on banking issued by the chief finance officer.

Responsibilities of chief finance officer – investments and borrowing

3.106 To ensure that all investments of money are made in the name of the authority or in the name of nominees approved by the full council.

3.107 To ensure that all securities that are the property of the authority or its nominees and the title deeds of all property in the authority's ownership are held in the custody of the appropriate chief officer.

3.108 To effect all borrowings in the name of the authority.

3.109 To act as the authority's registrar of stocks, bonds and mortgages and to maintain records of all borrowing of money by the authority.

Responsibilities of chief officers – investments and borrowing

3.110 To ensure that loans are not made to third parties and that interests are not acquired in companies, joint ventures or other enterprises without the approval of the full council, following consultation with the chief finance officer.

Responsibilities of chief officers – trust funds and funds held for third parties

3.111 To arrange for all trust funds to be held, wherever possible, in the name of the authority. All officers acting as trustees by virtue of their official position shall deposit securities, etc relating to the trust with the chief finance officer, unless the deed otherwise provides.

3.112 To arrange, where funds are held on behalf of third parties, for their secure administration, approved by the chief finance officer, and to maintain written records of all transactions.

3.113 To ensure that trust funds are operated within any relevant legislation and the specific requirements for each trust.

Responsibilities of the chief finance officer – imprest accounts

3.114 To provide employees of the authority with cash or bank imprest accounts to meet minor expenditure on behalf of the authority and to prescribe rules for operating these accounts. Minor items of expenditure should not exceed the prescribed amount.

3.115 To determine the petty cash limit and to maintain a record of all transactions and petty cash advances made, and periodically to review the arrangements for the safe custody and control of these advances.

3.116 To reimburse imprest holders as often as necessary to restore the imprests, but normally not more than monthly.

Responsibilities of chief officers – imprest accounts

3.117 To ensure that employees operating an imprest account:

(a) obtain and retain vouchers to support each payment from the imprest account. Where appropriate, an official receipted VAT invoice must be obtained

(b) make adequate arrangements for the safe custody of the account
(c) produce upon demand by the chief finance officer cash and all vouchers to the total value of the imprest amount
(d) record transactions promptly
(e) reconcile and balance the account at least monthly; reconciliation sheets to be signed and retained by the imprest holder
(f) provide the chief finance officer with a certificate of the value of the account held at 31 March each year
(g) ensure that the float is never used to cash personal cheques or to make personal loans and that the only payments into the account are the reimbursement of the float and change relating to purchases where an advance has been made
(h) on leaving the authority’s employment or otherwise ceasing to be entitled to hold an imprest advance, an employee shall account to the chief finance officer for the amount advanced to him or her.