APPENDIX 1

TREASURY MANAGEMENT STRATEGY – 2010/2011

Treasury Limits for 2010/11 to 2012/13

It is a statutory duty under s.3 of the Local Government Act 2003, and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. This amount is termed the 'Affordable Borrowing Limit'.

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

The Affordable Borrowing Limit must include all planned capital investment to be financed by external borrowing and any other forms of liability, such as credit arrangements. The Affordable Borrowing Limit is to be set on a rolling basis for the forthcoming year and two successive financial years.

Prudential Indicators for 2010/11 – 2012/13

The following prudential indicators are relevant for the purposes of setting an integrated treasury management strategy.

The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This was adopted in January 2002 by full Council.

Following a report by Parliament's Communities and Local Government Select Committee in May 2009, CIPFA published a revised Code of Practice in November 2009. Those changes have been incorporated into this report, and it is proposed that the revised Code of Practice is formally adopted by Council.

In addition, the Department for Communities and Local Government (CLG) is currently consulting on revised guidance on local authority investments, which is expected to apply from April 2010 onwards. Both the existing 2004 guidance and the proposed 2010 guidance require the Council to approve an investment strategy before the start of each financial year.

Treasury Management Prudential Indicators for 2010/11 – 2012/13

PRUDENTIAL INDICATOR	2008/09	2009/10	2010/11	2011/12	2012/13
Treasury Management Indicators	£'000	£'000	£'000	£'000	£'000
Authorised limit for external debt					
These limits include current commitments and proposals in the budget report for capital expenditure, plus additional headroom over & above the operational limit for unusual cash movements. The lower borrowing levels compared to the Capital Financing Requirement represents the proposed use of internal balances given the low interest rates obtained on investments.					
borrowing	105,000	85,000	115,000	137,000	145,000
Other long term liabilities	2,000	2,000	3,000	3,000	3,000
Cumulative Total	**107,000**	**87,000**	**118,000**	**140,000**	**148,000**
Operational limit for external debt					
The operational boundary for external debt is based on the same estimates as the authorised limit but without the additional headroom for unusual cash movements.					
borrowing	100,000	80,000	105,000	130,000	137,000
other long term liabilities	2,000	2,000	2,000	2,000	2,000
Cumulative Total	**102,000**	**82,000**	**107,000**	**132,000**	**139,000**
Interest Rate Exposures					
These indicators are set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest exposures, expressed as a percentage of net principle borrowed will be:					
Upper limit for fixed interest rate exposure					
This is the maximum amount of total net borrowing which can be at fixed interest rate.	£102m	£82m	£107m	£132m	£139m
Upper limit for variable interest rate exposure					
While fixed rate interest contributes significantly to reducing uncertainty surrounding interest rate changes, the pursuit of optimum performance levels may justify keeping a degree of flexibility through the use of variable interest rates.					
This is the maximum amount of total net borrowing which can be at variable interest rates.	£56m	£41m	£20m	£20m	£20m

Upper limit for total principal sums invested for over 364 days					
The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The indicator sets an upper limit for longer term investments that represent its core cash balances that are unlikely to be needed for short term cash flow purposes.					
	2008/09	**2009/10**	**2010/11**	**2011/12**	**2012/13**
The maximum % of total investments which can be over 364 days.	80%	80%	25%	25%	25%

Maturity structure of borrowing
The following indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

Maturity Structure of fixed rate borrowing	Upper limit	Lower limit
Under 12 months	50%	NIL
12 months and within 24 months	50%	NIL
24 months and within 5 years	50%	NIL
5 years and within 10 years	50%	NIL
10 years and above	100%	NIL

This indicator applies to the financial years 2010/11, 2011/12 and 2012/13. Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Impact of International Financial Reporting Standards (IFRS) on Prudential Indicators
The Council is currently assessing the potential impact of adoption of IFRS from 1st April 2010. The main potential impact on the Prudential Indicators above is in relation to the treatment of leases. Under IFRS, some leases which have in the past been classified as operating leases (funded from revenue) may be required to be classified as finance leases (funded from capital) depending on criteria set out in the lease agreement. The affordable and operating borrowing limits above provide for this change. If any further aspects of IFRS implementation, which would include any future PFI (Private Finance Initiative) schemes, affect the Prudential Indicators revisions may need to be reported to Council for approval.

Current Portfolio Position
The Council's treasury portfolio position at 31st December 2009 comprised:

	Principal	**Ave. rate**
	£m	%
Total Fixed rate funding	PWLB 60	4.22
Variable rate funding	Market 20	4.50*
Other long term liabilities	Nil	N/A
TOTAL DEBT	**80**	**4.29**
TOTAL INVESTMENTS**	**93.3**	**1.12**
NET INVESTMENTS	**13.3**	**-**

* The market loans are ‘lenders options’ or LOBO’s. These are fixed at a relatively low rate of interest for an initial period but then revert to a higher rate of 4.5%. When the initial period is over the loans are then classed as variable, as the lender has the option to change the interest rate at 6 monthly intervals, however at this point the borrower has the option to repay the loan without penalty.
** Total Investments includes Schools balances where schools have not opted for an external bank account and cash balances related to the Avon Pension Fund, PCT Pooled budgets and West of England Growth Points funding.

Prospects for Interest Rates

The Council has appointed Sterling Treasury Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following section gives their commentary on the economic context and views on the prospects for future interest rates.

Economic Context

The UK is currently in the longest, if not the deepest, recession since World War Two. Bank failures, combined with rising energy and commodity prices, caused a sharp reduction in consumer and business spending in 2008, with a resulting negative impact on GDP growth and employment. Financial institutions exacerbated the recession by restricting credit in an effort to repair their own balance sheets, although extensive government and central bank intervention has supported economic activity to an extent.

However, the discretionary fiscal stimulus, bank rescues, increased benefit payments and reduced tax revenues have caused a significant deterioration in the national finances. Public sector net borrowing is expected to exceed £175bn in 2009/10, and remain high in subsequent years, pushing the national debt towards 100% of GDP. Whatever the result of the 2010 general election, the next government is expected to cut spending and raise taxes, slowing the country’s economic recovery.

Although the UK economy is expected to have returned to growth in the last quarter of 2009, restricted bank lending and fiscal tightening mean it is unlikely that the absolute level of GDP will return to pre-recession levels in the near term. The resultant spare capacity is likely to keep inflation low in the medium term. The Bank of England recognises that simultaneous fiscal and monetary tightening could endanger the economy’s recovery, and it is therefore likely to exercise caution before raising interest rates in the absence of obvious inflationary pressures.

The scope for short-term interest rate rises in 2010/11 is therefore limited. Bank Rate could remain at 0.5% for the whole of 2010, increasing quite rapidly thereafter, but remaining below pre-recession levels into 2012. Money market rates, such as LIBOR, will rise earlier in anticipation of monetary tightening, but they are also likely to remain close to record lows for a considerable period. Long-term PWLB rates are expected to rise slowly due to a large increase in the supply of gilts over the next few years, but this will be mostly offset by the demand created by new liquidity requirements for financial institutions.

Sterling Consultancy Services central interest rate forecast – November 2009

	Bank Rate	1 month LIBOR	3 month LIBOR	12 month LIBOR	25 year PWLB	50 year PWLB
Current	0.50	0.51	0.61	1.21	4.40	4.35
Q1 2010	0.50	0.55	0.70	1.30	4.55	4.55
Q2 2010	0.50	0.55	0.75	1.35	4.60	4.60
Q3 2010	0.50	0.55	0.80	1.40	4.70	4.70
Q4 2010	0.50	0.60	0.90	1.55	4.75	4.75
H1 2011	1.00	1.10	1.50	2.00	4.80	4.80
H2 2011	2.00	2.20	2.50	3.00	4.85	4.85
H1 2012	3.00	3.20	3.50	4.00	4.90	4.90

HM Treasury Survey of Forecasts – November 2009

	Average annual Bank Rate %			
	2010	2011	2012	2013
Highest	1.30	3.30	4.30	4.60
Average	0.70	1.70	3.00	3.80
Lowest	0.50	0.50	1.00	1.40

Sterling’s current interest rate view is that Bank Rate: -

- Will remain at 0.5% until the first half of 2011 when it will increase to 1% followed by further 1% increases during the second half of 2011 and in the first half of 2012 taking the rate to 3%.

Money market rates, such as LIBOR, will rise earlier in anticipation of monetary tightening, but they are likely to remain close to record lows for a considerable period.

The Council has budgeted for interest rates at 1.0% for 2010/11, 2.0% for 2011/12 & 3.0% thereafter. This is compared to Sterling’s view of 0.9%, 2.4% & 3.5% based on 3 month LIBOR rates.

Borrowing Strategy

The Council currently holds £80 million of long-term loans. No borrowing is expected during 2009/10 in line with the policy of using internal resources rather than external borrowing following concerns regarding elevated levels of credit risk and in light of the level of the Council’s cash balances.
The Council’s capital financing requirement (CFR, or underlying need to borrow) as at 31st March 2010 is expected to be £95 million, and is forecast to rise to £137 million by March 2011 as capital expenditure is incurred.

The maximum expected long-term borrowing requirement for 2010/11 is:

	£m
Not borrowed in previous years	15
Forecast increase in CFR	42
Loans maturing in 2010/11	0
TOTAL	57

However, depending on the pattern of interest rates during the year, it may be more cost effective to defer borrowing until later years, and to temporarily reduce the size of the Council's investment balance instead. The capital financing budget for borrowing in 2010/11 assumes borrowing of £25 million is taken during the year, whilst continuing with use of temporary use of internal resources to fund capital spend.

In addition, the Council may borrow for short periods of time (normally up to two weeks) to cover unexpected cash flow shortages.

Sources of borrowing

The approved sources of long-term and short-term borrowing will be:

- Public Works Loan Board
- any institution approved for investments above
- any other bank or building society on the Financial Services Authority list

Debt instruments

Loans will be arranged by one of the following debt instruments:

- fixed term loans at fixed or variable rates of interest, subject to the Prudential Indicators above.
- lender's option borrower's option (LOBO) loans, subject to limits on variable rate borrowing set out in the Prudential Indicators above.

As an alternative to borrowing loans, the Council may also finance capital expenditure and incur long-term liabilities by means of:

- leases
- Private Finance Initiative

Borrowing strategy to be followed

With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to not borrow and reduce the level of investments held instead. However, with long-term rates forecast to rise in the coming years, any such short-term savings will need to be balanced against potential longer-term costs. Officers will keep the borrowing strategy under review during the year and take advice from our external advisers with reference to movements in the differential between short term and long term interest rates.

The Public Works Loan Board allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. The Council may take advantage of this and replace some higher rate loans with new loans at lower interest rates where this will lead to an overall saving or reduce risk.

All rescheduling will be reported in the next available Treasury Management Monitoring report following its action with all rescheduling detailed in the annual review report.