APPENDIX 1

TREASURY MANAGEMENT STRATEGY – 2011/2012

Treasury Limits for 2011/12 to 2013/14

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 2011/12 – 2013/14

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. The revised code was formally adopted by Council in February 2010.

In addition, the Department for Communities and Local Government (CLG) issued revised guidance on Local Authority investments in March 2010, which require the Council to approve an investment strategy before the start of each financial year.

Treasury Management Prudential Indicators for 2011/12 – 2013/14

PRUDENTIAL INDICATOR	2009/10	2010/11	2011/12	2012/13	2013/14
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 increase between 2010/11 and 2011/12 reflects the borrowing requirement of the 3 year Capital Programme, enabling the Council to have flexibility in using financial instruments to borrow in advance of need.					
borrowing	85,000	115,000	*201,000*	*201,000*	*207,000*
Other long term liabilities	2,000	3,000	*3,000*	*3,000*	*3,000*
Cumulative Total	**87,000**	**118,000**	***204,000***	***204,000***	***210,000***
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 and without the capacity for borrowing in advance of need.					
borrowing	80,000	105,000	*150,000*	*177,000*	*204,000*
other long term liabilities	2,000	2,000	*2,000*	*2,000*	*2,000*
Cumulative Total	**82,000**	**107,000**	***152,000***	***179,000***	***206,000***
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 the amount 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.	£82m	£107m	*£204m*	*£204m*	*£206m*
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 borrowing which can be at variable interest rates less any investments at variable interest rates (including fixed rate investments under 12 months).	£41m	£20m	*£0m*	*£0m*	*£0m*

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.					
	2009/10	**2010/11**	**2011/12**	**2012/13**	**2013/14**
The maximum % of total investments which can be over 364 days.	80%	25%	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 2011/12, 2012/13 and 2013/14. 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.

Current Portfolio Position
The Council's treasury portfolio position at 31st December 2010 comprised:

	Principal	**Ave. rate**
	£m	%
Total Fixed rate funding	PWLB 70	4.26
Variable rate funding	Market 20	4.50*
Other long term liabilities	Nil	N/A
TOTAL DEBT	**90**	**4.32**
TOTAL INVESTMENTS**	**76.1**	**1.09**
NET DEBT	**13.9**	**-**

* 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 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 strength of the UK economy's recovery from recession has surprised analysts and policymakers alike. A 2.0% increase in the six months to September left gross domestic product 2.8% higher than a year ago. Economic activity has been boosted by three main factors: the exceptionally loose stance of monetary policy, the lower value of sterling and the recovery in international trade. With exports cheaper because of the depreciation of sterling, the recovery in global trade has primarily benefited the manufacturing sector

Despite the recession, inflation has remained stubbornly high. The annual change in the consumer price index increased to 3.2% in October, and has been above the 2% target for 36 of the past 45 months. A number of factors have boosted consumer price inflation. The resumption of the 17.5% VAT rate, a rise in commodity prices and higher import prices due to the past depreciation of sterling have acted to offset the effect from weaker domestic demand.

The current factors boosting inflation are considered temporary by members of the Bank of England's Monetary Policy Committee (MPC) and not representative of the underlying demand and supply situation. Inflation is expected to remain above target throughout 2011, but fall below target in 2012 as the effect of these temporary factors wanes. This outlook is driven by the expectation that potential supply comfortably exceeds demand, and that this significant margin of spare capacity will bear down on pricing pressure. The continuing poor availability of credit and forthcoming fiscal tightening are expected to weigh on domestic demand throughout the forecast period.

The outlook suggests the MPC will look to maintain the current level of accommodative monetary policy to support demand in the face of considerable headwinds. Our central forecast therefore sees Bank Rate remaining at 0.5% for most of 2011, and although rising thereafter, remaining below "normal" levels until 2013. Longer-term interest rates are likely to rise slowly as the economic situation improves and government borrowing increases, but the rate of increase will be tempered by the coalition government's austerity measures and the safe haven status of UK government debt.

The high level of uncertainty surrounding the economic and geo-political outlook means there are substantial risks to both the up- and downside. The speed of monetary tightening depends on the recovery in domestic demand, which in turn depends on private sector confidence and the strength of the global economy. Long-term rates may rise more significantly if risk appetite increases due to faster economic growth or, if planned spending cuts undershoot expectations, the government loses investor confidence. Equally rates could fall in the event of a sovereign default or non-financial event, as long as the UK retains its safe haven status.

Sterling Consultancy Services central interest rate forecast – November 2010

	Bank Rate	*1 month LIBOR*	*3 month LIBOR*	*12 month LIBOR*	*25 year PWLB*
Current	*0.50*	*0.57*	*0.74*	*1.47*	*5.26*
Q1 2011	*0.50*	*0.60*	*0.80*	*1.60*	*5.45*
Q2 2011	*0.50*	*0.60*	*0.90*	*2.00*	*5.55*
Q3 2011	*0.50*	*0.60*	*1.00*	*2.50*	*5.65*
Q4 2011	*1.00*	*1.10*	*1.50*	*2.75*	*5.75*
H1 2012	*2.00*	*2.10*	*2.50*	*3.50*	*5.85*
H2 2012	*3.00*	*3.10*	*3.50*	*4.25*	*5.95*
H1 2013	*4.00*	*4.10*	*4.50*	*5.00*	*6.05*

HM Treasury Survey of Forecasts – November 2010

	Average annual Bank Rate %			
	2011	*2012*	*2013*	*2014*
Highest	*1.8*	*3.1*	*3.6*	*4.5*
Average	*0.7*	*1.5*	*2.5*	*3.1*
Lowest	*0.5*	*0.5*	*0.6*	*1.2*

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, the first half of 2012 and again in the second half of 21012, taking the rate to 4%.

The Council has budgeted for interest rates at 1.0% for 2011/12, 2.0% for 2012/13 & 3.0% thereafter. This is broadly in line with Sterling's view of 1.13%, 2.02% & 2.97% based on 3 month LIBOR rates.

Borrowing Strategy

The Council currently holds £90 million of long-term loans. No further borrowing is anticipated during the remainder of 2010/11.
The Council's capital financing requirement (CFR, or underlying need to borrow) as at 31st March 2011 is expected to be £125 million, and is forecast to rise to £151 million by March 2012 as capital expenditure is incurred.

The maximum expected long-term borrowing requirement for 2011/12 is:

	£m
Not borrowed in previous years	35
Forecast increase in CFR	26
Loans maturing in 2011/12	0
TOTAL	61

Looking at available borrowing instruments may now be cost effective in light of changes to PWLB borrowing rate increases. However, depending on the pattern of interest rates during the year, it may be more beneficial 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 2011/12 assumes borrowing of £35 million is taken during the year.

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

<u>Sources of borrowing</u>
The approved sources of long-term and short-term borrowing will be:

- Public Works Loan Board
- any institution approved for investments as listed in the Authorised Counterparty List
- any other bank or building society on the Financial Services Authority list
- Public or Private Bond Placement

<u>Debt instruments</u>
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.
- bonds

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

<u>Borrowing strategy to be followed</u>

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 Council has previously raised the majority of its long-term borrowing from the Public Works Loan Board. However, the government's recent decision to raise the interest rates on new PWLB loans by around 0.85% means that other sources of finance may now be more favourable. In light of this the Council will be exploring alternative methods of borrowing which may be more cost effective. One example would be a Bond Issue where indicative savings of 0.25% to 0.50% over PWLB rates may be achievable.

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.