WARWICK DISTRICT COUNCIL	**Finance and Audit Scrutiny Committee** **9th August 2011.**	**Agenda Item No.** **6**

Title	2010/11 Annual Treasury Management Report
For further information about this report please contact	Roger Wyton, Principal Accountant 01926 45801 e mail: roger.wyton@warwickdc.gov.uk
Wards of the District directly affected	None
Is the report private and confidential and not for publication by virtue of a paragraph of schedule 12A of the Local Government Act 1972, following the Local Government (Access to Information) (Variation) Order 2006	No
Date and meeting when issue was last considered and relevant minute number	N/A
Background Papers	Treasury Management Annual Strategy Plan 2010/2011 Various documents from Sector Treasury Services CIPFA Treasury Management Benchmarking report for 2010/2011

Contrary to the policy framework:	No
Contrary to the budgetary framework:	No
Key Decision?	No
Included within the Forward Plan? (If yes include reference number)	No
Equality & Sustainability Impact Assessment Undertaken	No – not relevant

Officer/Councillor Approval

Officer Approval	**Date**	**Name**
Chief Executive/Deputy Chief Executive	21/07/2011	Andy Jones
Head of Service	21/07/2011	Andy Jones
CMT	N/A	
Section 151 Officer	21/07/2011	Mike Snow
Monitoring Officer	N/A	
Finance	25/07/2011	Roger Wyton
Portfolio Holder(s)	N/A	

Consultation & Community Engagement

None

Final Decision?	Yes

Suggested next steps (if not final decision please set out below)

N/A

1. **SUMMARY**

1.1. The Council is required to report upon its 2010/11 Treasury Management performance by 30th September. This report therefore details and reviews the Council's performance for the whole of 2010/11 and is attached as Appendix A.

1.2 Consideration of the Council's Treasury Management activities is within the remit of the Finance and Audit Scrutiny Committee hence, it is appropriate to report the Council's annual performance direct to this Committee.

1.3 The report follows the format used in the Treasury Management Strategy Plan presented to the Executive on 3rd February 2010, and comments where appropriate, on the Council's actual performance against what was forecast in the Strategy Plan, a copy of which is attached for reference purposes as Appendix B. The Council also has to comment upon its performance against its Annual Investment Strategy for the year, a copy of which is attached as Appendix C.

2. **RECOMMENDATION**

2.1 That the Members of the Finance and Audit Scrutiny Committee note the contents of this report.

3. **REASONS FOR THE RECOMMENDATION**

3.1 The 2010/11 Treasury Management Strategy and the Council's Treasury Management Practices, in accordance with the Code of Practice for Treasury Management, require that the Treasury Management function reports upon its activities during the year by no later than 30th September in the year after that which is being reported upon.

4. **POLICY FRAMEWORK**

4.1 Treasury Management will support the Council in achieving its aims as set out in "Fit for the Future".

5. **BUDGETARY FRAMEWORK**

5.1 Treasury Management has a potentially significant impact on the Council's budget through its ability to maximise its investment interest income and minimise borrowing interest payable. The Council is reliant upon interest received to help fund the services it provides. As detailed in paragraph 11.9, the net interest received by the General Fund for 2010/11 was £362,000 against a revised estimate of £352,000 and original of £274,000.

6. **ALTERNATIVE OPTION CONSIDERED**

6.1 None.

APPENDIX A

2010/11 ANNUAL TREASURY MANAGEMENT REPORT

7. REVIEW OF THE INTEREST RATE ENVIRONMENT.

7.1 Based on the view of our Treasury Consultants, Sector, the 2010/11 Annual Strategy Plan was based upon Bank Rates at an unprecedented historically low level of 0.5% at the start of the year. Some modest recovery in the UK economy was anticipated with Bank Rate increasing to 0.75% by September 2010 and to 1.0% by the end of the financial year. As a counterpoint, the view of Capital Economics was that Bank Rate would not move away from 0.50% throughout 2010 and 2011.

7.2 UK growth proved mixed over the year. The first half of the year saw the economy outperform expectations, although the economy slipped into negative territory in the final quarter of 2010 due to inclement weather conditions. The year finished with prospects for the UK economy being decidedly downbeat over the short to medium term while the Japanese disasters in March, and the Arab Spring, especially the crisis in Libya, caused an increase in world oil prices, which all combined to dampen international economic growth prospects.

7.3 The change in the UK political background was a major factor behind weaker domestic growth expectations. The new coalition Government struck an aggressive fiscal policy stance, evidenced through heavy spending cuts announced in the October Comprehensive Spending Review, and the lack of any "giveaway" in the March 2011 Budget. Although the main aim was to reduce the national debt burden to a sustainable level, the measures are also expected to act as a significant drag on growth.

7.4 Gilt yields fell for much of the first half of the year as financial markets drew considerable reassurance from the Government's debt reduction plans, especially in the light of Euro zone sovereign debt concerns. Expectations of further quantitative easing also helped to push yields to historic lows. However, this positive performance was mostly reversed in the closing months of 2010 as sentiment changed due to sharply rising inflation pressures. These were also expected (during February / March 2011) to cause the Monetary Policy Committee to start raising Bank Rate earlier than previously expected.

7.5 The developing Euro zone peripheral sovereign debt crisis caused considerable concerns in financial markets. First Greece (May), then Ireland (December), were forced to accept assistance from a combined EU / IMF rescue package. Subsequently, fears steadily grew about Portugal, although it managed to put off accepting assistance till after the year end. These worries caused international investors to seek safe havens in investing in non-Euro zone government bonds.

7.6 Deposit rates picked up modestly in the second half of the year as rising inflationary concerns, and strong first half growth, fed through to prospects of an earlier start to increases in Bank Rate. However, in March 2011, slowing actual growth, together with weak growth prospects, saw consensus expectations of the first UK rate rise move back from May to August 2011 despite high inflation. However, the disparity of expectations on domestic economic growth and inflation encouraged a wide range of views on the timing of the start of increases in Bank Rate in a band from May 2011 through to early 2013. This sharp disparity was also seen in MPC voting which, by year-end, had three members voting for a rise while others preferred to continue maintaining rates at ultra low levels.

7.7 Risk premiums were also a constant factor in raising money market deposit rates beyond 3 months. Although market sentiment has improved, continued Euro zone concerns, and the significant funding issues still faced by many financial institutions, mean that investors remain cautious of longer-term commitment. The European Commission did try to address market concerns through a stress test of major financial institutions in July 2010. Although only a small minority of banks "failed" the test, investors were highly sceptical as to the robustness of the tests, as they also are over further tests now taking place.

7.8 In summary, the tight monetary conditions following the 2008 financial crisis continued through 2010/11 with little material movement in the shorter term deposit rates. Bank Rate remained at its historical low of 0.5% throughout the year, although growing market expectations of the imminence of the start of monetary tightening saw 6 and 12 month rates picking up.

8. CAPITAL EXPENDITURE AND FINANCING

8.1 The Council's capital programme for 2010/11 amounted to £8,001,999 and was financed in the following manner:-

	2010/11 Actual		**Strategy Report**
	£		**£**
Prudential Borrowing	0		575,000
Capital Receipts	308,513		984,900
Revenue and Reserves	6,889,722		7,649,825
External Contributions and Grants	803,764		3,332,625
Total	**8,001,999**		**12,542,350**

9. TEMPORARY BORROWING

9.1 The Council managed its cash flow during the year such as to not require any temporary borrowing.

10. TREASURY LIMITS AND PRUDENTIAL INDICATORS

10.1 The Prudential Capital Finance system was introduced on 1st April 2004. The system is regulated by a number of Prudential Indicators, a number of which are relevant for treasury management purposes and are included in the Annual Strategy Report. The table below shows the outturn against those quoted in the Strategy Report:-

	2010/11 Out-turn		**2010/11 Strategy Report**
	£		**£**
Authorised Limit for External Debt			
Borrowing (year end)*	0		10,900,000
Other Long term Liabilities (year end)*	0		200,000
Total	**0**		**11,100,000**
Operational Boundary for External Debt			
Borrowing (year end)*	0		2,900,000
Other Long term Liabilities (year end)*	0		200,000
Total	**0**		**3,100,000**
Capital Financing Requirement			
General Fund	-£1,326,896		-£1,326,896
Housing Revenue Account	-£370,204		-£370,204
Overall	**-£1,697,100**		**-£1,697,100**
Incremental Impact on Council Tax / Housing Rents			
Council Tax	£0.00		£0.94
Housing Rent	£0.00		£0.00

* At the 31st March 2011, the Council had no external borrowing either long or short term (e.g. bank overdraft) and no other long term liabilities.

10.2 In addition there are the following indicators relating to borrowing:-

<u>Upper limit to fixed interest rate and variable interest rate exposures</u>

Strategy Report - Upper Limit Fixed Rate = 100%
Actual – Upper Limit Fixed Rate = 100%

Strategy Report - Upper Limit Variable Rate = 30%
Actual – Upper Limit Variable Rate = 30%

Upper and lower limits respectively for the maturity structure of borrowing

Period	Upper	Lower
Under 12 months	100%	0%
12 months and within 24 months	15%	0%
24 months and within 5 years	37.5%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

In both cases the indicators were complied with as the only borrowing incurred by the Council in 2010/11 was its bank overdraft.

10.3 The final indicator monitors the amount invested for periods longer than 364 days which in 2010/11 was set at 40% of the investment portfolio subject to a maximum of £10,000,000. At year end, the Council had investments for a period of 365 days totalling £12,000,000 which represented 37% of the portfolio so therefore in terms of value this indicator was not complied with. However, as in each case, the investment duration exceeded the limit of 364 days by only 1 day this is not seen as a major breach of this indicator.

11. ANNUAL INVESTMENT STRATEGY AND INVESTMENT PERFORMANCE

11.1 The Approved Investment Regulations were abolished with effect from 1st April 2004 and replaced by guidance from the ODPM on local government investments. This guidance required the production of an Annual Investment Strategy which amongst other things outlined the investment vehicles which could be used by the Council and separated them off into Specified and Non Specified investments. The 2010/11 Annual Investment Strategy was approved by the Council in February 2010 and is reproduced as Appendix C.

11.2 During the year the in house investments were invested in the Money Markets and Money Market Funds and, with the exception of the limit referred to in paragraph 10.3 above, conformed with the Specified and Non Specified investments criteria laid out in the Annual Investment Strategy.

11.3 The in house function has invested both cash flow driven as well as core cash funds in fixed term deposits in the Money Markets. The table overleaf illustrates the performance, by quarter and for the year of the in house function for each category normally invested in:-

(It should be noted that this table reflects investments placed in the year and does not take into account loans that were placed during 2009/10 which matured during 2010/11)

Money Market Investments:

Period	Investment Return (Annualised)	LIBID Benchmark (Annualised)	Out/Under (-) Performance (Annualised)
Up to 7 days			
April - June	No investments made in this quarter		
July - September	No investments made in this quarter		
October – December	No investments made in this quarter		
January to March	No investments made in this quarter		
Annual Performance	**No investments made in year**		
Over 7 days and up to 3 months			
April - June	0.84%	0.44%	+0.40%
Value of Interest earned Q1	£13,145	£6,913	+£6,232
July - September	0.76%	0.46%	+0.30%
Value of Interest earned Q2	£19,643	£11,938	+£7,705
October - December	0.82%	0.47%	+0.35%
Value of Interest earned Q3	£17,927	£10,311	+£7,616
January to March	0.71%	0.51%	+0.20%
Value of Interest earned Q4	£5,227	£3,786	+£1,441
Annual Performance	**0.79%**	**0.47%**	**+0.32%**
Annual Interest	**£55,942**	**£32,948**	**+£22,994**
3 to 6 months			
April - June	0.84%	0.64%	+0.20%
Value of Interest earned Q1	£5,108	£3,856	+£1,252
July - September	0.75%	0.69%	+0.06%
Value of Interest earned Q2	£13,100	£12,134	+£966
October - December	0.68%	0.70%	-0.02%
Value of Interest earned Q3	£3,688	£3,821	-£133
January to March	No investments made in this quarter		
Annual Performance	**0.75%**	**0.68%**	**+0.07%**
Annual Interest	**£21,896**	**£19,811**	**+£2,085**
6 months to 363 days			
April - June	1.10%	0.99%	+0.11%
Value of Interest earned Q1	£22,422	£20,133	+£2,289

Period	Investment Return (Annualised)	LIBID Benchmark (Annualised)	Out/Under (-) Performance (Annualised)
July - September	No investments made in this quarter		
October - December	No investments made in this quarter		
January to March	No investments made in this quarter		
Annual Performance	**1.10%**	**0.99%**	**+0.11%**
Annual Interest	**£22,422**	**£20,133**	**+£2,289**
364 days and over			
April - June	1.47%	1.21%	+0.26%
Value of Interest earned Q1	£146,416	£120,538	+£25,878
July - September	1.41%	1.28%	+0.13%
Value of Interest earned Q2	£70,330	£64,031	+£6,299
October – December	1.40%	1.30%	+0.10%
Value of Interest earned Q3	£153,152	£142,603	+£10,549
January to March	1.47%	1.37%	+0.10%
Value of Interest earned Q4	£29,220	£27,375	+£1,845
Annual Performance	**1.43%**	**1.29%**	**+0.14%**
Annual Interest	**£399,118**	**£354,547**	**+£44,571**
Total Annual Interest – All categories.	**£499,378**	**£427,439**	**+£71,939**

11.4 Due to Money Market Funds outperforming the Up to 7 Day area of the Money Markets, this category was not used in 2010/11 for cash flow driven investments. As part of its active investment strategy as well as at certain times of the year when we reached the limit of what we could invest in our Money Market Funds, the Council made investments in the Up to 3 Months area of the Money Markets with the average length of a cashflow investment being just under three months. This area of the market outperformed the benchmark by some 0.32%, a margin which is pleasing given the current low levels of interest rates. The majority of investments were placed with Category C Building Societies and limited in accordance with our credit rating criteria to £1m for a maximum of three months per counterparty thus maximising return whilst keeping the capital security risk to a minimum.

11.5 The in house function utilised the AAA rated Invesco AIM, Standard Life and Prime Rate Money Market Funds to assist in managing its short term liquidity needs. The table overleaf illustrates the performance, by quarter and for the year of the three funds:

Money Market Funds:

Fund	Investment Return (Annualised)	LIBID Benchmark (Annualised)	Out/Under (-) Performance (Annualised)
Standard Life			
April – June	0.48%	0.42%	+0.06%
Value of Interest earned Q1	£1,769	£1,550	+£219
July – September	0.54%	0.43%	+0.11%
Value of Interest earned Q2	£2,893	£2,288	+£605
October – December	0.57%	0.43%	+0.14%
Value of Interest earned Q3	£4,106	£3,074	+£1,032
January - March	0.58%	0.45%	+0.13%
Value of Interest earned Q4	£4,431	£3,440	+£991
Annual Performance	**0.55%**	**0.43%**	**+0.12%**
Annual Interest	**£13,199**	**£10,352**	**+£2,847**
Invesco Aim			
April – June	0.49%	0.42%	+0.07%
Value of Interest earned Q1	£4,598	£3,997	+£601
July – September	0.52%	0.43%	+0.09%
Value of Interest earned Q2	£1,765	£1,456	+£309
October – December	0.53%	0.43%	+0.10%
Value of Interest earned Q3	£551	£446	+£105
January to March	0.52%	0.45%	+0.07%
Value of Interest earned Q4	£952	£827	+£125
Annual Performance	**0.50%**	**0.43%**	**+0.07%**
Annual Interest	**£7,866**	**£6,726**	**+£1,140**

Fund	Investment Return %	LIBID Benchmark %	Out/Under (-) Performance %
Prime Rate			
April – June	0.91%	0.42%	+0.49%
Value of Interest earned Q1	£11,350	£5,272	+£6,078
July – September	0.92%	0.43%	+0.49%
Value of Interest earned Q2	£11,184	£5,236	+£5,948
October – December	0.87%	0.43%	+0.44%
Value of Interest earned Q3	£9,953	£4,944	+£5,009
January to March	0.84%	0.45%	+0.39%
Value of Interest earned Q4	£9,856	£5,267	+£4,589
Annual Performance	**0.89%**	**0.43%**	**+0.46%**
Annual Interest	**£42,343**	**£20,719**	**+£21,624**
Total Annual Interest – All Funds.	**£63,408**	**£37,797**	**+£25,611**

11.6 The Up to 7 Days LIBID rate is the benchmark in this instance and it can be seen that the three funds made returns in excess of the benchmark thus justifying the decision to use them in preference to short term Money Market investments. The Prime Rate Money Market Fund performs particularly well compared to the others and this is as a result of it having a slightly longer weighted average maturity (WAM) than the other funds. This perceived greater risk thus yielding a higher return. However, it must be stressed that all Money Market Funds have to adhere to a very strict credit rating criteria and therefore funds with slightly more risk in them are still very safe.

11.7 The Council has access to two Bank Rate tracking Business Reserve Accounts with Santander (previously Abbey National) and Lloyds Banking Group (previously Bank of Scotland). Due to the low Bank Rate during the year and as better returns could be obtained from the Money Market Funds these reserve accounts were not used during 2010/11.

11.8 In paragraph 5.1 of the Annual Investment Strategy, the Council anticipated that it would have an average investment balance of around £36m during 2010/2011. The actual was £41.3m, the increase being partly accounted for by slippage in the capital programme leading to higher than expected balances in reserves and from increased cash flows during the year. The investment strategy of this cash would not have been any different had we known about this "additional" £5m. All core cash investments were invested on a rolling 364 day basis and the additional cash flow derived investments were invested in the Money Market Funds and short term (up to 3 months) Money Market investments, so there was no missed opportunity arising from this difference in the estimates. Paragraph 5.2 makes reference to a 60% minimum short term investments holding. The average investment balance in 2010/11 was £41.3m of which a maximum of £12m was invested for more than 364 days at any one time. This represents 29% of the Councils investments and is within the 40% which can be held in longer term investments. However, as already mentioned in paragraph 10.3 above, the Council did exceed the maximum total of £10m in respect of investments held for more than 364 days. The remainder of the Council's investments were in short term investments or investments which could be disposed of at short notice thus conforming with the 60% requirement. The Council continued to invest its cash flow driven money to known dates where large debts such as precepts, NNDR etc. had to be paid out. A comparison between 2009/10 actual, 2010/11 revised and 2010/11 actual in terms of in house investment interest returns and interest rates is shown in the table below:-

In House Investment Returns:

Year	Interest Received (£)	Interest Rate Achieved %
2009/109 actual	710,991	2.00
2010/11 revised	506,678	1.09
2010/11 actual	434,827	1.09

In the Annual Investment Strategy it was anticipated that the in house portfolio would achieve a 1.42% return for 2010/11. The actual rate of 1.09% reflects the fact that, due to the continuing poor economic conditions, the Bank of England has felt unable to raise Bank Rate from 0.50% to the expected 1.50% at the end of 2010/11 as reflected in the Annual Investment Strategy.

11.9 The table below compares the actual total interest received by the Council with what was expected when the original and revised estimates were calculated and also the 2009/10 actual:-

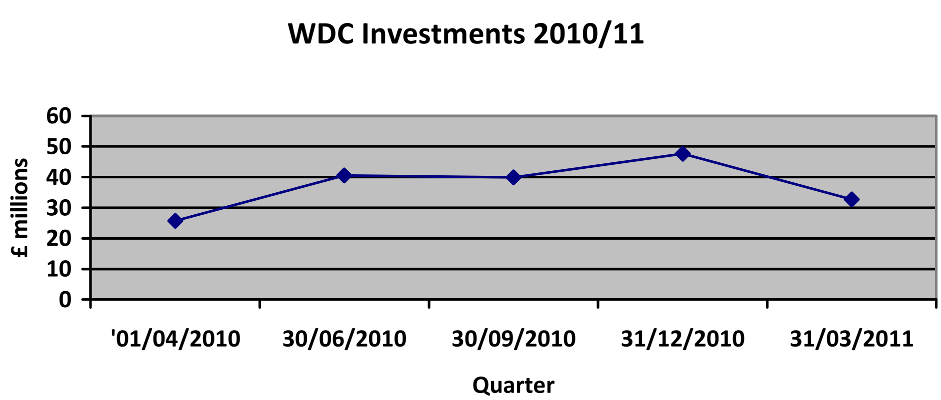
	Credited to General Fund	Credited to Housing Revenue Account	Total Investment Interest Earned
	£	**£**	**£**
2009/10 Actual	1,163,692	151,100	1,314,792
2010/11 Original	274,261	192,200	466,461
2010/11 Revised	352,978	153,700	506,678
2010/11 Actual	362,309	157,549	519,858

It should be borne in mind that the 2009/10 actual General Fund figures include £597,000 received in respect of interest on VAT refunds and therefore are not directly comparable with the 2010/11 figures. The Council also received a smaller payment of £68,000 in respect of interest on VAT refunds in 2010/11 which partially accounts for the difference between the 2010/11 original of £274,000 and the actual of £362,000.

11.10 An analysis of the overall investments of the Council as at 31st March 2011 is shown in the table below, with the previous year's figures shown for comparison purposes:

IN HOUSE	**31st March 2011**	**31st March 2010**
TYPE OF INVESTMENT	**£**	**£**
Money Markets	29,000,000	24,000,000
Money Market Funds	3,686,000	1,700,000
Total	**32,686,000**	**25,700,000**

11.11 The graph below shows how the total of the Council's investments varies through the year according to its cash flows, It illustrates that during the period April to December the Council's investments grow as cash flows in from such sources as Council Tax and NNDR and then from January onwards how the investments decline as cash flows out e.g. precepts exceed that coming in.



12. BROKERS PERFORMANCE

12.1 The performance of the brokers that WDC uses to place its Money Market investments has been measured against the rates available in the market on the day that the investments were placed in order to ensure that WDC is obtaining a reasonable rate given the size of deposit that WDC normally places. Since the advent of the Business Reserve Accounts and Money Market Funds, the number of investments placed through brokers has much reduced but the analysis shows that the brokers in general either achieved or exceeded the going rate for the day.

13. PERFORMANCE MEASUREMENT

13.1 In addition to the in house local benchmarks referred to in the table in paragraph 11.3 the Council had intended to benchmark its investment performance using Sector's risk management benchmarking service. Unfortunately, the launch of this service was delayed and it didn't get off the ground until 2011/12. Therefore, the Council rejoined the CIPFA Treasury Management Benchmarking Club for a further year which enables us to continue to benchmark ourselves on a national basis. The benchmarking club performance indicators included in the Strategy Plan are shown below:-

Table A

	2010/11 Benchmark £	WDC Performance £
Total In House Cost	£660	£270
In House Staff Costs	£520	£270

Table B

	2010/11 Benchmark %	WDC Performance %	WDC Average Balance £'m
Fixed Investments > than 365 days	3.20	1.39	6.50
Fixed Investments < than 365 days	1.21	1.13	26.08
Call Investments	0.61	Not used	n/a
Money Market Funds	0.60	0.73	8.76
Combined In House Investments	1.52	1.08	41.34

Table C

	2010/11 Benchmark £	WDC Performance £
	TBC	26,000

13.2 Table A shows that the total in house cost and staff cost per £1m invested was much lower than our comparator councils. At the time of writing it is not possible to analyse the reason why this should be the case as we are still awaiting the necessary information from the benchmarking club. This should be available by the time Finance & Audit Scrutiny meet and Members will be updated accordingly.

13.3 Table B shows that in respect of fixed investments for more than 364 days the Council's return was well below the average 3.20% benchmark at 1.39%. Again, due to the necessary information not being available it is not possible to accurately identify the reasons for the below average performance, however it is likely that some of the other authorities in the comparator group are investing for considerably longer periods than this Council (the Council made no investments longer than 365 days in 2010/11) in order to generate returns of 3% and above. Having a longer duration in the portfolio generates a higher return, however, this Council is currently giving heightened regard to liquidity and minimising counterparty credit risk and so a consequence of this will be a lower yield. Again, Members will be updated when the information becomes available.

In the fixed investments for less than 364 days this Council achieved 1.13% compared to an average benchmark of 1.21%. Analysis of the benchmarking club data shows that the average is skewed by one of the comparators achieving a return of 3% whereas the majority of the other comparators achieved returns either below or around about our own. Given the relatively short duration of this investment category, it is likely that the comparator achieving the 3% return is doing so by investing in counterparties with a significantly greater risk of potential credit default than those utilised by this Council. Further analysis will be carried out once the necessary information has been received from the benchmarking club.

The Call Investments category in Table B relates to Business Reserve and Bank Rate Tracking accounts which this Council did not use during 2010/11. Instead of using these base rate tracker accounts, this Council made more use of the Money Market Funds, which offer and enhanced return whilst still maintaining liquidity. This Council achieved a return of 0.73% compared to average benchmark of 0.60%. The reason for this enhanced return is due to the Council using Funds with slightly more capital risk in them which in turn generates a better return. It has to be stressed that all Money Market Funds have to adhere to a very strict credit rating criteria and therefore funds with slightly more risk in them are still very safe, it merely means that the basket of investments in the fund (Gilts, Corporate Bonds, C.D's etc) has a slightly longer maturity profile and carries higher interest rates as a consequence.

13.4 Table C compares the WDC cost of treasury management against the comparator group average. Again, as we are still awaiting the necessary information from the benchmarking club it is not possible to assess the cost of the WDC treasury management function against the benchmark at this point in time and Members will be updated when the information becomes available.

14. THE EURO

14.1 The Treasury Management Strategy Plan requires the Treasury Management function to keep up to date with matters relating to the UK's possible entry into the Euro. During 2010/2011, very little happened nationally with regard to the possible introduction of the Euro to the United Kingdom but a watching brief was kept on the matter.

15. EXTERNAL TREASURY MANAGEMENT ADVISERS

15.1 Sector Treasury Services Ltd. continues to provide our Treasury Management Advisory service. The service was retendered in January 2010 and following a full tender evaluation process the contract was renewed with Sector for a three year period, with an option to extend this for a further two years.

ANNUAL TREASURY MANAGEMENT STRATEGY PLAN 2010/11
(As presented to Executive on 3rd February 2010)

1. GENERAL

1.1 This part of the report outlines the strategy that the Council will follow during 2010/11. Its production and submission to the Executive is a requirement of the C.I.P.F.A. Code of Practice on Treasury Management in the Public Services.

1.2 The suggested strategy for 2010/11 in respect of the treasury management function is based upon the officer's view on interest rates, supplemented with leading market forecasts provided by Sector Treasury Services who are the Council's treasury advisers.

1.3 The 2003 Prudential Code for Capital Finance in local authorities introduced new requirements for the manner in which capital spending plans are to be considered and approved, and in conjunction with this, the development of an integrated treasury management strategy. The Prudential Code requires the Council to set a number of Prudential Indicators and this report does therefore incorporate the indicators to which regard should be given when determining the Council's treasury management strategy for the next 3 financial years.

1.4 It is also a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from a) increases in interest charges caused by increased borrowing to finance additional capital expenditure b) any increases in running costs from new capital projects and c) the loss of interest on balances or reserves arising from their use in financing the capital expenditure are limited to a level which is affordable within the projected income of the council for the foreseeable future. This is covered by the Prudential Indicator calculating the Incremental Impact on the Council Tax or Housing Rent in paragraph 5.3 below.

1.5 The Council's treasury management operations are also governed by various Treasury Management Practices (TMP's), the production of which was a requirement of the CIPFA code and which must be explicitly followed by officers engaged in treasury management. These have previously been reported to the Executive and approved. There have been the following changes to the Treasury Management Practices (TMP's) which are included as Appendix E for information

TMP 1 Risk Management

Paragraph 2.3 – the maximum amount of core investments that can be invested for more than 364 days is reduced from £15m to £10m to reflect an expected reduction in the balances which make up the core investments and following the events of 2008 also from a prudence perspective.

<u>TMP2 Best Value and Performance Management</u>

Paragraph 1.5 – reflects the fact that the recent re-tendering exercise for our Treasury consultants provided for a two year extension of the initial three contract and this will be the case for all future tendering exercises.

<u>TMP4 Approved Instruments, Methods and Techniques</u>

Paragraph 2.1 – amendments to the Approved Investments Guidance in 2007 allowed the use of Real Estate Investment Trusts as investment vehicles which did not count as capital expenditure. Although, it is unlikely that we will ever use them they have been added as M) to the list of approved instruments.

I n addition, the use of CD's and Gilts has, in the past, been restricted to external fund managers. Following the Council's termination of its fund management contract with Invesco, the use of C.D's and Gilts through a custodian has been extended to include the in house function as well.

<u>TMP6 Reporting Requirements and Management Information Arrangements</u>

Paragraphs 1.3 & 1.4 – the latest version of the CIPFA Treasury Management Code of Practice and Guidance Notes requires formal recognition of the body charged by the Council with overseeing the Treasury Management function. For us, this is the Finance and Audit Scrutiny Committee hence the amendments to this TMP and the recommendation at 2.1(b) above.

<u>TMP11 Use of External Service Providers</u>

Paragraph 1.1 – removes reference to Invesco as our external investment agents but retains parameters should we wish to appoint fresh agents

Paragraphs 2.1 & 3.2 – updates the TMP with the latest details of the Treasury Management consultants and Council's banker's contracts.

2 INTEREST RATE FORECASTS FOR 2010/11

2.1 The ability to forecast the movement of interest rates is fundamental to successful investment and borrowing strategies. The Council's advisers, Sector Treasury Services, provide information which is compiled by experienced economists who have a proven track record. Their latest view on both short and long term rates is shown overleaf and has been used to formulate the investment interest estimates used in the budget report elsewhere on this agenda.

(Q/E = quarter end e.g. March, June, September and December)

	Q/E2 2010	Q/E3 2010	Q/E4 2010	Q/E1 2011	Q/E2 2011	Q/E3 2011	Q/E4 2011	Q/E1 2012	Q/E2 2012	Q/E3 2012	Q/E4 2012	Q/E1 2013
Bank Rate	0.50%	0.75%	1.00%	1.50%	2.25%	2.75%	3.25%	3.50%	3.75%	4.25%	4.25%	4.50%
5yr PWLB Rate	3.20%	3.30%	3.40%	3.60%	3.85%	4.15%	4.55%	4.60%	4.80%	4.80%	4.85%	4.85%
10yr PWLB Rate	4.05%	4.15%	4.30%	4.45%	4.60%	4.80%	4.90%	5.00%	5.10%	5.10%	5.15%	5.15%
25yr PWLB Rate	4.65%	4.70%	4.80%	4.90%	5.00%	5.05%	5.10%	5.20%	5.30%	5.30%	5.35%	5.35%
50yr PWLB Rate	4.70%	4.75%	4.90%	5.00%	5.10%	5.15%	5.20%	5.30%	5.40%	5.40%	5.45%	5.45%

2.2 At this point in time it is difficult to have confidence as to exactly how strong the UK economic recovery will be or when it will start but Sector feels that there will be a moderate return to growth commencing in mid to late 2010. However, there are uncertainties surrounding the forecast due to difficulty in forecasting the degree and severity of any fiscal contraction after the general election, the timing and amounts of Quantitative Easing reversal, the speed of recovery in the banking sector, changes in the pattern of consumer spending i.e. a move away from saving to spending and the rebalancing of the UK economy towards exporting. Sector feel that the overall balance of risks is weighted to the downside i.e. the pace of economic growth will be disappointing and Bank Rate increases will be delayed or not occur at the rate forecast.

2.3 As a counterpoint to Sectors interest rate view, Capital Economics take a more pessimistic view of any recovery and are not forecasting Bank Rate to rise from its current 0.50% throughout 2010 and 2011 whereas UBS' view is broadly in line with Sector..

3 CAPITAL BORROWING AND CAPITAL PROGRAMME FINANCING STRATEGY

3.1 The Council is able to finance its capital programme in the following ways:-

a) By the use of Prudential Borrowing. It is anticipated that £575,000 borrowing will take place in 2010/11 to fund the purchase of 18B

Southbank Road to facilitate the disposal of Wilton House in advance of the Kenilworth Public Service Centre project. However, this will be dependent on how the spend on the 2010/11 capital programme progresses and such factors as slippage could mean that this borrowing may not take place. If it does, it is likely to be of a short term nature as the sale of Wilton House is projected to occur before the end of 2010/11 and the borrowing will be repaid out of this capital receipt.

b) From Usable capital receipts. It is anticipated that there will be no significant capital receipts generated in 2010/11 to finance capital expenditure and any financing from capital receipts will be by way of drawing down receipts brought forward from previous years.

c) From revenue or reserves.

d) From external contributions and grants . With regard to the General Fund capital programme, it is anticipated that £2,525,000 contributions will be used in 2010/11 mainly Advantage West Midlands Grant in respect of the Spencers Yard project. With regard to the Housing Investment Programme it is expected that grants and contributions amounting to £808,000 will be utilised to finance General Fund Housing, mainly Improvement Grants

3.2 The Council's proposed 2010/11 General Fund capital programme amounts to £4,848,550. It is currently intended to finance this as follows:-

a) Contributions from revenue and reserves £1,748,925
b) External contributions and grants amounting to £2,524,625
c) Short term borrowing £575,000

3.3 The Council's 2010/11 expected Housing Investment Programme amounts to £7,693,800 and currently will be financed as follows:-

a) £808,000 capital grants and contributions
b) £984,900 capital receipts from the sale of council houses in previous years
c) £5,900,900 from revenue and reserves

4. TEMPORARY BORROWING

4.1 The Council will continue to engage in short term borrowing (up to 364 days) when necessary in order to finance temporary cash deficits, however by managing our cash flow effectively these will be kept to a minimum. In each case, wherever possible, the loan will be taken out for periods of less than 7 days in order to minimise the interest payable.

5. TREASURY LIMITS AND PRUDENTIAL INDICATORS FOR 2010/11 TO 2012/13

5.1 It is a statutory duty under Section 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. The amount so determined is termed the "Authorised Limit". The Council must have regard to the Prudential Code when setting its Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax / rent levels is acceptable. Whilst termed an Authorised Limit, the capital plans to be considered for inclusion incorporate those planned to be financed by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

5.2 The Authorised Limits to be recommended to Council by the Executive are included in the Budget report elsewhere on this agenda and are expected to be ratified by the Council at its meeting on 24th February. They are also displayed in the table below :-

Year	Authorised Limit for Borrowing	Authorised Limit for Other Long Term Liabilities	Authorised Limit for External Debt
2010/11	£10,900,000	£200,000	£11,100,000
2011/12	£10,980,000	£200,000	£11,180,000
2012/13	£11,518,000	£200,000	£11,718,000

5.3 The Prudential Indicators required by the code are explained in more detail in the report on the budget and those relevant to an integrated treasury management strategy are reproduced below:-

That the Council has adopted the CIPFA Treasury Management Code of Practice which it did a number of years ago.

Capital Financing Requirement

Year	General Fund	HRA	Overall
2010/11	-£1,326,896	-£370,204	-£1,697,100
2011/12	-£1,326,896	-£370,204	-£1,697,100
2012/13	-£1,326,896	-£370,204	-£1,697,100

Incremental Impact on Council Tax / Housing Rents

Year	Council Tax	Housing Rent
2010/11	£1.14	£0.00
2011/12	£1.86	£0.00
2012/13	£2.43	£0.00

Operational Boundary for External Debt

Year	Operational Boundary for Borrowing	Operational Boundary for Other Long Term Liabilities	Operational Boundary for external debt
2010/11	£2,900,000	£200,000	£3,100,000
2011/12	£2,980,000	£200,000	£3,180,000
2012/13	£3,518,000	£200,000	£3,718,000

In addition certain indicators that used to be part of the Prudential Code are now part of the Treasury Management Code of Practice and are shown below:-

Upper limits to fixed interest rate and variable interest rate exposures

Year	Upper Limit - Fixed Rate	Upper Limit - Variable Rate
2010/11	100%	30%
2011/12	100%	30%
2012/13	100%	30%

Upper and Lower Limits respectively for the Maturity Structure of Borrowing

Period	Upper	Lower
Under 12 months	100%	0%
12 months and within 24 months	15%	0%
24 months and within 5 years	37.50%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

Principal sums invested for periods longer than 364 days

The total maximum sum that can be invested for more than 364 days is 40% of the core investment portfolio subject to a maximum of £10 million at any one time.

6. ANNUAL INVESTMENT STRATEGY.

6.1 The Council is required to have regard to investment strategy requirements in the CIPFA Treasury Management Code and to produce an Annual Investment Strategy. Section 15(1) of the 2003 Local Government Act requires councils to have regard to such guidance as the Secretary of State may issue. Guidance was issued in 2004 and has subsequently been updated with a further review currently under way. The general policy objective is that local authorities should invest prudently the temporarily surplus funds held on behalf of their communities. The Annual Investment Strategy must be drawn up before the commencement of the year to which it relates and be approved by the full

Council. The Strategy can be amended at any time and it must be made available to the public.

6.2 The responsibility for risk management and control lies within the Council and the Strategy should set out the local authority's policies for giving priority to the security and liquidity of its investments, rather than to the yield. The guidance requires that investments should be classified as either of Specified or Non Specified Investments. Specified Investments are those that offer high security and high liquidity typically with another local authority, the UK Government or a body or investment scheme which has been awarded a high credit rating by one of the three main credit rating agencies. The Annual Investment Strategy must state how a high credit rating is to be defined and how frequently credit ratings are to be monitored together with what action is to be taken if a rating should change. All Specified Investments must be in sterling and with a maturity of no more than a year.

6.3 All other investments not meeting the criteria of a Specified Investment are to be regarded as Non Specified Investments and the Annual Investment Strategy is to set out procedures for determining what categories of investments may prudently be used and then also to identify what those categories actually are. The Strategy must also state the maximum amounts which can be held in each identified category at any one time during the financial year (by reference to a sum of money or a percentage of the Council's overall investments).

6.4 The Annual Investment Strategy must also set out procedures for determining the maximum periods for which funds may prudently be committed and also state the minimum amount during the financial year which is to held in short term investments. The latter is by reference to a sum of money or a percentage of the Councils overall investments.

6.5 The Council's Annual Investment Strategy for 2010/11 is contained within Appendix B.

7. BEST VALUE

7.1 Until Summer 2010, the Council participated in the C.I.P.F.A. Treasury Management Benchmarking Club in order to obtain external benchmarks against which it could compare its performance and also to obtain data on what other Council's were doing in the field of treasury management which could be used to improve the in house performance and management of risks. The Council's Treasury Consultants run a risk management benchmark service and also operate a model investment portfolio against which we will be able to benchmark our investment returns so it has been decided to use these to benchmark our in house performance for 2010/11 with a view to returning to the C.I.P.F.A. club in future years should the Treasury Consultants service not be satisfactory. This relates to 2010/11 and data will be available from the CIPFA Benchmarking Club for inclusion in the 2009/10 Annual Treasury Management report which will be presented to the Finance and Audit Scrutiny Committee during the Summer.

7.2 The internal treasury function will also seek to achieve an average rate of return on its Money Market investments of 1/16th% below the LIBID (London Inter Bank

Bid Rate) average for comparable investment periods (e.g. up to 7 day, 1 to 3 months, 3 to 6 months and over 6 months).

7.3 Due to recent past poor performance, the Council will be terminating its investment management agreement with Invesco and taking its £5m portfolio back in house. Should the Council employ external investment agents during 2010/11suitable performance indicators will be agreed with the agents similar to that which operated under the previous Invesco agreement e.g. the fund will be required to outperform the Financial Times 7 day LIBID rate compounded weekly with a target return of 110% of the benchmark over a 3 year rolling period.

7.4 The Council's performance for the year is reported in the Annual Treasury Management report which is presented to the Finance and Audit Scrutiny Committee after the end of the year to which it relates.

8. THE EURO

8.1 Currently the United Kingdom has not passed all of the five economic tests set by the Government as part of the potential process for this country to join the Euro currency. The move towards parity between Sterling and the Euro which has happened over the past eighteen months or so has focussed attention again on this issue and as there is no guarantee that the five tests will not be met at some point in the future, there is a need for some ongoing precautionary planning for the impact on the Authority and in this particular case, treasury management. The Treasury Management function will keep a watching brief on the subject and also review the Council's Euro Changeover Plan to ensure its currency..

9. EXTERNAL TREASURY MANAGEMENT ADVISERS

9.1 The Council employs Sector Treasury Services as its Treasury Management advisers. In January 2010, following a tendering process involving three other suppliers of Treasury Management Consultancy services their contract was renewed for another three years at £7,450 per annum subject to annual increases based on the Consumer Prices Index (CPI) with an option to extend for a further two years

10. BANKING SERVICES

10.1 The Council currently employs HSBC Bank to provide its banking services and . the current contract expires on 1st March 2010. A review of the contract was undertaken by Focus on Banking (financed by the West Midlands Regional Improvement and Efficiency Partnership, WMRIEP) who recommended that rather than go out to formal tender, the Council should seek to extend its current contract with HSBC as it was unlikely that better terms could be obtained by formally tendering. In conjunction with the Council's Procurement Officer, negotiations were entered into with HSBC which resulted in the Council renewing its contract with the bank for another 5 years with effect from 1st March 2010 at a cost similar to that currently paid..

11. OTHER ISSUES

11.1 The Council's treasury consultants, in conjunction with a number of other authorities , have devised a scheme whereby a Local Authority will guarantee to the lending bank a proportion of a borrowers mortgage against default. The scheme is aimed at enabling people who are capable of affording the monthly repayments on a mortgage but who are unable to provide the increased deposits that mortgage lenders are currently demanding following the "credit crunch" to enter the housing market and thus free up properties for social housing purposes. The Council is considering joining this scheme and this will be the subject of a future report to the Executive. Should we join, this will involve the making of a two year investment at an attractive interest rate with the bank giving the mortgage. The investment will be the security against which any defaults will be charged and the Treasury Management function will be advising on the treasury management implications of the scheme.

11.2 As part of its review of the HRA Subsidy system, the Government is currently considering the implications of allowing Councils to buy themselves out of the Subsidy system by taking on the debt that the Government currently pays subsidy on. This could result in this Council taking on over £100m of borrowings which will have a significant impact on its treasury management operations particularly with regard to debt management. The Treasury Management function will ensure that it is kept fully aware of developments in this field during 2010/11 and has begun the process by ensuring that the recently tendered contract for our Treasury Management consultancy includes provision for specific advice on debt management should the Council take on debt of this magnitude.

APPENDIX C

2010/11 ANNUAL INVESTMENT STRATEGY

1. BACKGROUND

1.1 This Council has regard to the Governments Guidance on Local Government Investments and CIPFA's updated Treasury Management in Public Services Code of Practice. The guidance states that an Annual Investment Strategy must be produced in advance of the year to which it relates.

2. INVESTMENTS

2.1 This Annual Investment Strategy states which investments the Council may use for the prudent management of its treasury balances during the financial year under the heads of Specified and Non Specified Investments. These are listed in the tables overleaf.

2.2 Specified investments are defined as those with a high credit rating, which for this Council is a Fitch sovereign rating of AAA, at least F1 short term, A+ long term, Individual Rating B/C or failing that a state support indicator of 1 or 2. The Council will also have regard to the ratings published by the other 2 main agencies, Moody's and Standard & Poors together with any ratings watch notices issued by the 3 agencies as well as articles in the Financial press and market data. In addition to credit ratings the Council will also use Credit Default Swap data to determine the suitability of investing with counterparties. Credit Default Swaps (CDS) are a form of "insurance premium" against defaulting taken out by investors when making investments and if the Market perceives problems with the counterparty then the margin on the CDS will widen (i.e. the insurance premium will increase) thus providing warnings for future investors with that counterparty that it might have problems repaying their investment. The Council will monitor the CDS's on the counterparties within its lending list and if there are significant movements on a counterparty such as it moves out of a pre-determined range which will be determined with the aid of the Councils Treasury Consultants then that counterparty will be removed from the list until such time as it moves back within range. An explanation of credit rating terms appears in Appendix D. The investment must be for a maximum of 364 days.

Although the Council does not expect to use external investment agents in 2010/11, they are included in the circumstance of use column in the tables overleaf to allow for their possible use should it be appropriate to do so.

Specified Investments

Investment	Repayable/ Redeemable within 12 months?	Security / Minimum Credit Rating	Circumstance of Use	Maximum Period
Debt Management Agency Deposit	Yes	UK Government Backed	In House	364 days
Deposits with UK Government , Nationalised Industries, Public Corporations or other Local Authorities	Yes	High security e.g investment secured on all revenues of Local Authority	In House and by external fund manager	364 days
Deposits with Banks with maturities up to 1 year (inc. Business Call and Reserve Accounts) and including forward deals	Yes	Fitch Rating of AAA sovereign rating, Short term F1 Long Term A+ Individual B/C (if less than B/C State Support indicator of 1 or 2)	In House and by external fund manager	364 days in aggregate
Deposits with Building Societies including forward deals	Yes	Minimum Fitch rating of AAA Sovereign rating, Long Term A+ and Short term F1 – maximum of £4m Less than A+ Long Term but with Short term rating of F1 or above – maximum of £2m	In house and by external fund manager	364 days in aggregate

Investment	**Repayable/ Redeemable within 12 months?**	**Security / Minimum Credit Rating**	**Circumstance of Use**	**Maximum Period**
Money Market Funds	Yes	Either Standard & Poors AAAm or Moody's AAA and volatility rating MR1+ or Fitch AAA and volatility rating VR1+	In house and by external fund manager	Not defined as subject to cash flow requirements
Certificates of Deposit issued by Banks and Building Societies	Yes	Minimum Fitch Rating of AAA Sovereign rating, Short term F1 Long Term A+ Individual B/C (if less than B/C State Support indicator of 1 or 2)	In house buy and hold and External fund manager	364 days
Gilt Edged Securities	Yes	UK Govt. backed	In house buy and hold and External fund manager	Not defined
Eligible Bank Bills	Yes	Minimum credit rating as determined by external fund manager	External fund manager only	364 days
Treasury Bills	Yes	UK Govt. backed	External fund manager only	Not defined
Bonds issued by Supranational Institutions or Multi Lateral Development Banks	Yes	AAA or government guaranteed	In house buy and hold and External fund manager	Not defined

Investment	Repayable/ Redeemable within 12 months?	Security / Minimum Credit Rating	Circumstance of Use	Maximum Period
Sterling Securities guaranteed by HM Government	Yes	UK Govt. backed	External fund manager only	Not defined

2.3 As a means of further diversifying risk whilst obtaining a reasonable return for cash flow derived investments, the Council has gained access to the SunGard Money Market Funds Portal which will enable it to open further Money Market Funds and to be able to see on a daily basis before deciding with whom to invest which funds are offering the best rates.

Non Specified Investments

Investment	Repayable/ Redeemable within 12 months?	Security / Minimum Credit Rating	Circumstance of Use	Maximum Limit	Maximum Period
Deposits with unrated building societies	yes	Limited to those within the top 20 ranked by value.	In house	£1 million	3 months
Deposits with banks greater than 1 year (including any forward dealing)	No	Minimum Fitch Rating of AAA Sovereign rating Short term F1 Long Term A+ Individual B/C (if less than B/C State Support indicator of 1 or 2)	In house after consultation with Treasury Advisers External fund manager	£10 million (in total). Individual limit £5m per specified investments	2 years

Investment	Repayable/ Redeemable within 12 months?	Security / Minimum Credit Rating	Circumstance of Use	Maximum Limit	Maximum Period
Deposits with building societies greater than 1 year (including any forward dealing)	No	Minimum Fitch rating of AAA Sovereign rating Short term F1 Long Term A+	In house after consultation with Treasury Advisers External fund manager	As above - £10 million (in total). Individual limit £2m	2 years

2.4 It is necessary to outline the reasons why the Council would use non specified investments and also the risks involved. The use of unrated building societies alongside Business Reserve and Call Accounts and Money Market Funds forms a useful tool for investing relatively small amounts of money for short periods of time (up to 3 months) and obtaining a decent return on the investment. There is of course a risk that the Building Society may fail during the maximum 3 month duration of an investment but this is not considered likely for any unrated society in the top 20 as it is likely that a larger society would absorb them In practice, as these deposits are of a cash flow nature, the duration of any one deposit is likely to be around 1 to 2 months which lessens the risk still further. With regard to deposits for more than one year, the advantage from a treasury management point of view is that there is a known rate of return over the period that the monies are invested which aids forward planning. There is however the increased risk due to the longer time span that a) the institution fails or b) interest rates rise in the meantime. The current limit for investments longer than 364 days is 40% of the core investment portfolio subject to a maximum of £10 million at any one time. No investments for more than 1 year will be made without the advice of our Treasury Consultants on the likely movement of interest rates over the period of the proposed investment and any investments over 364 days with building societies will be limited to £2m per counterparty**.**

3. INVESTMENT OBJECTIVES

3.1 All investments will be in sterling. The Council's investment priorities are the security and liquidity of its investments. The Council's objective will be to maximise the return whilst safeguarding the capital sum and avoiding cash flow problems. The Council will not engage in borrowing for purely investment purposes.

4. SECURITY OF CAPITAL

4.1 The Council relies on credit ratings published by Fitch Ratings which are supplied to it by its Treasury Advisers, whilst not the principal credit rating service used by the Council, attention will also be paid to credit ratings published by Moody's Investor Services and Standard & Poor's which are also supplied by Sector in order to broaden the sources of intelligence from which the Council gathers opinions on the performance of its investment counterparties. These ratings are used to establish the credit quality of counterparties and investment schemes. These institutions also issue regular ratings watch bulletins and where these are negative and affect one of our counterparties this will be taken into account when deciding whether or not to place future investments with them. The Council has also determined the minimum long term (more than 1 year), short term (1 year or less) and other credit ratings it deems to be high for each category of investment and these are as shown in paragraph 2.1 above.

4.2 Individual credit ratings will be revised as and when changes are notified to the Council by its Treasury Advisers. If a counterparty's or investment scheme's rating is downgraded with the result that it no longer meets the Council's minimum criteria then the counterparty / investment vehicle will no longer be used with immediate effect. This also applies to investments placed by fund managers. Similarly if a counterparty is upgraded so that it meets the Council's minimum credit rating requirements then it will be added to the Council's counterparty list.

4.3 The Council will also use the Credit Default Swap (CDS) information supplied by its Treasury Consultants to determine levels of investments with its counterparties once they have been selected using the criteria set out in 2.2 above. Counterparties with an in range CDS (as determined by our consultants) will be invested in as per the limits defined for that particular category of counterparty . Those counterparties with a monitoring status will not be invested in without first referring to our consultants for advice and those counterparties with an out of range CDS will not be invested in until their CDS returns to within range.

5. INVESTMENT BALANCES / LIQUIDITY OF INVESTMENTS

5.1 Based on its cash flow forecasts, the Council anticipates that its investments in 2010/11 on average will be in the region of £36 million**.**

5.2 The maximum percentage of its core investments that the Council will hold in long term investments (365 days or over) is 40%. It follows therefore that the minimum percentage of its overall investments that the Council will hold in short term investments (364 days or less) is 60% . Having regard to the Council's likely cash flows and levels of funds available for investment the amount available for long term investment will be a maximum of 40% of the core investment portfolio subject to a total of £10 million at any one time in line with the proposed Prudential Indicator covering this issue. These limits will apply jointly to the in house team and fund manager so that the overall ceilings of 40% and £10 million are not breached.

6. INVESTMENT STRATEGY

6.1 The Council will continue to invest cash flow driven money to known dates where large debts such as precepts, NNDR etc. have to be paid out. Based on the cash flow experienced to date in 2009/10 it is unlikely that this will result in the average length of an investment being more than 3 months in 2010/11. Core investments (i.e. investments not needed for payment of debts), including the £5m formerly managed by Invesco, will continue to be invested in the best part of the market based on the advice issued by our Treasury Advisers.

6.2 The 2010/11 interest rate outlook is for Bank Rate to rise from 0.50% at the beginning of the year to 1.50% at the end..In order to take advantage of this rising interest rate environment, depending on when they mature the Council will seek to place its core investments in vehicles which pay the best possible rates whilst maintaining liquidity so that they can be re-invested as rates rise through the year. Following the demise of Invesco as the Councils external fund manager, the in house function may make use of C.D's and Gilts through a Custodian. The use of these instruments will be on the advice of our Treasury Consultants and is likely to be on a buy and hold to maturity basis in order to lock in certainty of return.

6.3 The recent banking crisis has heightened interest in high quality counterparty security and in order to gain the interest of the highest quality counterparties who typically are only interested in investments of £5m and upwards, the Council will give consideration to accumulating funds so that investments of that size can be placed. Given the expected rising interest rate environment, it is likely that cash flow driven investments will be invested in a variety of vehicles e.g. Money Markets, Money Market Funds and Bank Rate tracking or beating bank accounts such as those run by Bank of Scotland and Abbey National.

6.4 Although likely to lag behind the Money Markets and Bank Rate tracking or beating accounts, it is expected that high performing triple A rated Money Market Funds will continue to be used in instances where the amounts of cash available for investment or the period of time before the cash is required make the Money Markets unattractive and the Bank Rate tracking or beating accounts have reached their counterparty limits.The Money Market Funds may also be used to store maturing core investments until sufficient has accumulated for a deposit to be made as related above. Depending on the exact timing of the predicted Bank Rate changes it is expected that the portfolio will achieve a 1.42% return for 2010/11.

7. EXTERNAL CASH FUND MANAGEMENT

7.1 Prior to 2010/11Invesco managed a portfolio of £5m on our behalf. Following a long period of unsatisfactory performance, the agreement with Invesco was terminated and the portfolio brought back in house. The performance of fund managers will be kept under review using our Treasury Consultants and should it be felt appropriate to do so then the Council may engage a fund manager in order to enhance returns and spread risk. The appointment process will be handled in conjunction with our Treasury Consultants in order to ensure that the Council secures best value.

8. END OF YEAR INVESTMENT REPORT

8.1 At the end of the financial year, the Council will prepare a report on its investment activity as part of its Annual Treasury Report.