Inverclyde council

AGENDA ITEM NO. 10

Report To:	**Policy & Resources Committee**	**Date**:	**31 March 2009**
Report By:	**Chief Financial Officer**	**Report No:**	**FIN/30/09/AP/CB**
Contact Officer:	**Alan Puckrin**	**Contact No**:	**01475 712223**
Subject:	**TREASURY MANAGEMENT – STRATEGY 2009/10**		

1.0 PURPOSE

1.1 The purpose of this report is to seek approval for the Treasury Management Strategy for 2009/10 and the Council's Prudential Indicators for the next 3 years.

2.0 SUMMARY

2.1 The report proposes the Council's Treasury Management Strategy for 2009/10 and Prudential Indicators for the next 3 years.

2.2 The Treasury Management Strategy and Prudential Indicators have been set based on the Council's current and projected financial position (including projected capital expenditure) and on expected interest rate levels.

3.0 RECOMMENDATIONS

3.1 It is recommended that the Committee approves the Prudential Indicators and Strategy outlined in the report.

3.2 It is recommended that the Committee approves the following addition to the Council's Counterparty Criteria: "Where a UK Bank has been nationalised or has received substantial support from the UK Government (involving more than 50% ownership) then the maximum investment will be £15 million and the maximum period for an investment will be 364 days."

Alan Puckrin
Chief Financial Officer

4.0 BACKGROUND

4.1 The Local Government in Scotland Act 2003 and supporting regulations require the Council to 'have regard to' the Prudential Code and therefore to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. The CIPFA Code of Practice on Treasury Management in the Public Services also requires the Council to set out its treasury management strategy for borrowing and investment.

4.2 The suggested strategy for 2009/10 in respect of the following aspects of the treasury management function is based upon the officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury consultants.

The strategy covers:

- treasury limits in force which will limit the treasury risk and activities of the Council;
- Prudential Indicators;
- the current treasury position;
- the borrowing requirement;
- prospects for interest rates;
- the borrowing strategy;
- debt rescheduling;
- the investment strategy;
- any extraordinary treasury issues.

4.3 It is a statutory requirement, under Section 93 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, a local authority must 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 interest charges caused by increased borrowing to finance additional capital expenditure and from any increases in running costs from new capital projects are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

4.4 Treasury Management is a complex area with its own terminology and acronyms. In order to aid the Committee's understanding a Glossary of Terms is attached as Appendix 1.

5.0 PROPOSED TREASURY STRATEGY AND PRUDENTIAL INDICATORS

Treasury Limits For 2009/10 To 2011/12

5.1 It is a statutory duty under part 7 of the Local Government in Scotland Act 2003 and supporting regulations for the Council to determine and keep under review how much it can afford to allocate to capital expenditure. This amount is termed the "Affordable Capital Expenditure Limit".

5.2 The Council must have regard to the Prudential Code when setting the Affordable Capital Expenditure 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 levels is 'affordable'.

5.3 Whilst termed an "Affordable Capital Expenditure Limit", the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability. The affordable capital expenditure limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

Prudential Indicators For 2009/10 To 2011/12

5.4 Inverclyde Council has adopted the CIPFA Code of Practice on Treasury Management.

5.5 The main Prudential Indicators are as follows:

	2007/08	2008/09	2009/10	2010/11	2011/12
	Actual	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Capital Expenditure (Indicator 5)	£000	£000	£000	£000	£000
Non – HRA	39,994	24,710	25,669	20,693	28,644
HRA	7,576	0	0	0	0
TOTAL	47,570	24,710	25,669	20,693	28,644
Ratio of financing costs to net revenue stream (Indicator 1)					
Non – HRA	10.38%	8.60%	8.34%	8.36%	8.73%
HRA	39.85%	0.00%	0.00%	0.00%	0.00%
Net borrowing requirement (Indicator 4)	£000	£000	£000	£000	£000
As At 31 March	(29,422)	(36,857)	(30,402)	(30,402)	(34,402)
Capital Financing Requirement as at 31 March (Indicator 6)	£000	£000	£000	£000	£000
Non – HRA	172,567	197,545	199,028	205,807	220,096
HRA	0	0	0	0	0
TOTAL	172,567	197,545	199,028	205,807	220,096
Upper limit for total principal sums invested for over 364 days (Indicator 14)	£0	£20,000,000 *	£20,000,000 *	£20,000,000 *	£20,000,000 *

* - Subject to new regulations being issued by the Scottish Government.

	2007/08	2008/09	2009/10	2010/11	2011/12
	Estimate	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Authorised limit for external debt (Indicator 7)	£000	£000	£000	£000	£000
Borrowing	286,853	217,300	222,911	230,504	246,508
Other long term liabilities	0	0	0	0	0
TOTAL	286,853	217,300	222,911	230,504	246,508
Operational boundary for external debt (Indicator 8)	£000	£000	£000	£000	£000
Borrowing	273,814	207,422	212,960	220,213	235,503
Other long term liabilities	0	0	0	0	0
TOTAL	273,814	207,422	212,960	220,213	235,503

	2009/10	2010/11	2011/12
	Estimate	**Estimate**	**Estimate**
Incremental impact of capital investment decisions			
Incremental increase in council tax (band D) per annum (Indicator 2)	£33.62	£18.55	£14.16
Upper limit for fixed interest rate exposure (Indicator 11)	130%	130%	130%
Upper limit for variable rate exposure (Indicator 12)	30%	30%	30%

5.6 The limits on the maturity of fixed rate borrowing during 2009/10 (Indicator 13) are as follows:

Maturity Structure	Upper Limit	Lower Limit
Under 12 months	30%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	30%	0%
5 years and within 10 years	45%	0%
10 years and above	100%	55%

Current Portfolio Position

5.7 The Council's treasury portfolio position at 25/2/2009 comprised:

		Principal		**Average Rate**
		£000	£000	
Fixed rate funding	PWLB	90,782		
	Market	45,000	135,782	4.162%
Variable rate funding	PWLB	0		
	Market	57,953	57,953	4.086%
Other long term liabilities			0	0.000%
TOTAL DEBT			**193,735**	**4.139%**
TOTAL INVESTMENTS			**53,004**	**4.105%**

Borrowing Requirement

5.8 The Council's borrowing requirement is as follows:

	2007/08	2008/09	2009/10	2010/11	2011/12
	£000 Actual	£000 Projected	£000 Estimate	£000 Estimate	£000 Estimate
New borrowing	20,000	30,000	0	5,000	10,000
Alternative financing arrangements	0	0	0	0	0
Replacement borrowing	0	0	10,000	0	4,000
TOTAL	20,000	30,000	10,000	5,000	14,000

Prospects For Interest Rates

5.9 The Council has appointed Sector Treasury Services Ltd as treasury consultants and part of their service is to assist the Council to formulate a view on interest rates. The table in 5.10 gives the Sector view.

5.10 Sector interest rate forecast – 12th February 2009

	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009	Q/E1 2010	Q/E2 2010	Q/E3 2010	Q/E4 2010	Q/E1 2011	Q/E2 2011	Q/E3 2011	Q/E4 2011	Q/E1 2012
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.75%	2.50%	3.25%	3.75%	4.00%
5yr PWLB rate	2.60%	2.45%	2.30%	2.30%	2.30%	2.50%	2.85%	3.15%	3.65%	3.95%	4.20%	4.45%	4.60%
10yr PWLB rate	3.60%	3.35%	3.20%	3.20%	3.25%	3.35%	3.60%	3.95%	4.30%	4.55%	4.80%	4.85%	4.90%
25yr PWLB rate	4.15%	4.05%	4.00%	4.00%	4.10%	4.15%	4.35%	4.45%	4.60%	4.85%	4.95%	5.05%	5.10%
50yr PWLB rate	4.10%	3.95%	3.90%	3.90%	3.95%	4.00%	4.05%	4.25%	4.45%	4.70%	4.85%	4.95%	5.05%

5.11 **Economic Background**

Introduction

- The sub prime crisis of early 2008 was supplanted by the banking crisis of autumn 2008. The world banking system came near to collapse and governments around the world were forced to recapitalise and rescue their major banks. The resulting dearth of lending from banks anxious to preserve capital led to economic forecasts being sharply reduced and recession priced into markets. This in turn led to sharp falls in oil and other commodity prices with the result that inflation, which in the UK was running at over 5%, became yesterday's story and recession fears drove interest rate sentiment and policy. A co-ordinated global interest rate cut of 0.5% took place on 8th October 2008. Forecasts in the UK were for further sharp cuts in interest rates as recession hove into view.

International

- Early in 2008 the US economy was being badly affected by the housing market slump. Interest rates were at 2% and inflation was being dragged higher by the inexorable rise in commodity prices. The European Central Bank ("ECB") was very concerned about rising inflation and less about the state of the economy.
- The second quarter of 2008 was torn between inflation worries on the one hand, with oil rising towards $150 per barrel, and the deteriorating economic outlook on the other.
- In the second and third quarters of the year the financial crisis erupted and escalated as the world became aware of the extent of the sub-prime fiasco and the impact it was having on institutions that had invested in these issues.
- In September Fannie Mae/Freddie Mac (the mortgage banks) and AIG (the insurance giant) had to be bailed out by the US Federal Government.
- Then in mid September, Lehman Brothers (an investment bank) was allowed to fail. This triggered a domino effect with other banks and financial institutions having to be rescued or supported by governments around the world.
- After the collapse into receivership of the Icelandic banks in early October, other countries then started to feel the strain and a number had to approach the International Monetary Fund ("IMF") for support.
- Eventually even the Asian "Tiger" economies were affected, including India and China, and it became clear that the crisis had become a global one and no country was insulated from it.
- The financial crisis had therefore precipitated an economic crisis and there was a co-ordinated global interest rate cut with the US Federal Reserve, the ECB and the Bank of England Monetary Policy Committee ("MPC") all cutting rates by 0.5% on 8th October. The Federal Reserve subsequently cut rates again by 0.5% to 1% on 29th October and again on 16th December to a band of between 0.0% and 0.25% in an attempt to stave off the oncoming recession. Inflation was yesterday's problem.
- On 4th November the USA elected Barack Obama as President with little immediate financial impact.
- The ECB reduced rates again in November by 0.5%, in December by its biggest ever cut of 0.75%, and in January by another 0.5% to 2%, followed by no change in February.

UK

- GDP: growth was already slowing in 2008 from 2007 before the full impact of the credit crunch was felt. Earlier in 2008 GDP was 2.3% whereas in quarter 3 it fell 0.3% and then fell by 1.5% in quarter 4 to give a year-on-year figure of -1.8%. GDP forecasts for 2009 are now in the -2.5% to -3.5% area.
- Wage inflation remained relatively subdued as the Government kept a firm lid on public sector pay. Private sector wage growth was kept in check by the slowing economy.
- Growth slowed across the economy and unemployment rose towards the end of the year to very nearly break through the 2 million barrier in January 2009. Unemployment is expected to continue to increase towards 3 million in 2009.
- Bank lending came to a virtual standstill in the autumn of 2008 as the credit crunch tightened its grip and various banks internationally had to be rescued, or supported, by their governments.

- The Government and the Bank of England supplied massive amounts of liquidity to the banking market in an attempt to reignite longer interbank lending.
- The Government announced in October a £500bn package of measures to support the banking system and the economy. This included £37bn to recapitalise some of the major clearing banks and a requirement for the others to strengthen their capital ratios by their own capital raising efforts. The aim of this was to try to ensure that these banks would be seen to have sufficient reserves to last through the coming recession with its inevitable increase in bad loans etc. However, a second bank support package proved necessary in January 2009.
- The housing market also came to a virtual standstill as lenders demanded larger deposits and higher fees. House sales and prices both dropped sharply.
- Government finances deteriorated as income from taxation dropped as the economy slowed and the cost of the bailout of the banks was added to the deficit.
- UK share prices declined sharply in the 3rd and 4th quarters as the impending recession was priced into the markets. Prices hit five year lows and volatility was extremely high.
- The story of 2008 has been the credit crunch, the banking crisis and the change in economic outlook from slow growth to outright recession. After the initial concerns about the impact of the credit crunch in the earlier part of 2008 it appeared as though the storm had been weathered. The MPC had been very concerned about Consumer Prices Index inflation ("CPI") which had been rising sharply on the back of higher commodity and food prices. The Bank Rate reached a peak of 5.75% in July 2007 after which cuts of 0.25% occurred in December 2007 and February and April 2008 before the major cuts in the autumn of 2008. The economic data had been indicating a slowing economy for some while but it was not sufficiently weak to force the MPC into another cut. It was the strength of the banking crisis, pre-empted by the collapse of Lehman Brothers in New York that eventually drove the MPC to cut interest rates by 0.5% on 8th October in concert with the Federal Reserve, the ECB and other central banks. It was then appreciated that the economic downturn would be much more severe than previously thought and interest rates were subsequently slashed by 1.5% in November, 1% in December, 0.5% in January, and by another 0.5% in February to reach 1%.
- The differences between the Inter-Bank Borrowing rates ("LIBOR") and the Bank Rate have also been a feature and a concern of 2008/09. Because of the credit fears and the reluctance of lenders to place cash for long periods 3 month LIBOR has been substantially higher than the Bank Rate set by the MPC. This has meant that the MPC's power over monetary policy has been eroded by the widening of this spread between LIBOR and Bank Rate and it has therefore had a limited ability to bring relief to hard pressed borrowers through lower interest rates. However, the power of the Government over the semi-nationalised clearing banks had considerable impact in enforcing pro-rata reductions to the 1.5% Bank Rate cut in November on some borrowing rates.
- The Government has abandoned its 'golden rule'. The Pre-Budget Report on 14th November revealed the Government's plans for a huge increase in Government borrowing over coming years as a result of falling tax revenues and also due to tax cuts and increases in Government expenditure in the short term designed to help stimulate economic growth to counter the recession.

Interest rate forecast

- The Bank Rate started on a downward trend from 5.75% in December 2007 with further cuts of 0.25% in February and April 2008, then 0.5% in October, 1.5% in November, 1% in December and 0.5% in January and February 2009 to reach 1%.
- The Bank Rate is forecast to fall to 0.5% during Q1 of 2009.
- It is then expected to stabilise at 0.5% until starting to rise gradually with the first increase in Q2 of 2010 and then to be back up to 4.00% during Q1 2012.

PWLB rates

- The 50 year PWLB rate is forecast to be around 3.90%-3.95% for most of 2009/10 and then to rise gradually to reach 4.45% in Q1 2011. The rate then edges up gradually to reach 5.05% in Q1 2012.
- The 25 year PWLB rate is expected to be between 4.00% and 4.10% during 2009/10 and then to start gradually rising in 2010/11 to reach 4.60% in Q1 2011. In 2011/12, the rise is expected to continue to reach 5.10% in Q1 2012.

- The 10 year PWLB rate is expected to drop to a floor of 3.20% in Q3 2009 but then to start rising again in Q1 2010 to reach 4.30% in Q1 2011 and then to continue rising to reach 4.90% in Q1 2012.
- The 5 year PWLB rate is expected to fall to a floor of 2.30% during Q3 2009. The rate then starts rising in Q2 2010 to reach 3.65% in Q1 2011 and then to continue rising to reach 4.60% in Q1 2012.

Borrowing Strategy

5.12 The interest rate forecasts indicate that there are a range of options available for borrowing strategy for 2009/10.

5.13 Variable rate borrowing is expected to be cheaper than long term borrowing and will therefore be attractive throughout the financial year compared to simply taking long term fixed rate borrowing. Under 10 year PWLB rates are expected to be substantially lower than longer term PWLB rates so this will open up a range of choices for new borrowing for authorities that want to spread their debt maturities away from a concentration in long dated debt. Rates are expected to be slightly lower at the middle to end of the year than earlier on so it may be advantageous to borrow later in the year.

5.14 The Council's treasury consultants advise that, for authorities wishing to minimise their debt interest costs, the main strategy is therefore as follows:

- For authorities wanting to focus on the very cheapest PWLB borrowing, the under 10 year rates will provide significantly cheaper rates than longer term borrowing. Under 5 year rates are also expected to be significantly lower than 5-10 year rates. Rates are expected to be slightly lower at the middle to end of the year than earlier on so it may be advantageous to borrow later in the year.
- For authorities wanting to lock into historically low long term rates, there is expected to be little difference between 25 year and 50 year rates. However, despite the minimally more expensive new borrowing rates expected in the 25-30 year period later in the year, these could be seen as being much more attractive than 50 year borrowing as the spread between the PWLB new borrowing and early repayment rates is considerably less. This then maximises the potential for debt rescheduling at a later time by minimising the spread between these two rates.
- This strategy would also mean that after some years of focusing on borrowing at or near the 50 year period, local authorities would be able to undertake borrowing in a markedly different period and so achieve a better spread in their debt maturity profile.
- When long term PWLB rates fall back to the central forecast rate of about 4%, borrowing should be made at any time in the financial year. A suitable trigger point for considering new fixed rate long term borrowing, therefore, would be 4%. The central forecast rate will be reviewed in the light of movements in the slope of the yield curve, spreads between PWLB new borrowing and early payment rates, and any further changes that the PWLB may introduce to their lending policy and operations.
- Consideration will also be given to borrowing fixed rate market loans at 0.25%-0.5% below the PWLB target rate if they become available again.

5.15 The treasury consultants also advise that:

- The next financial year is expected to be a time of historically abnormally low Bank Rates. This opens up an opportunity for authorities to fundamentally review their strategy of undertaking external borrowing.
- For those authorities with investments in excess of their borrowing requirement over the next year and access to the cash from maturing investments within the financial year, then consideration also needs to be given to the potential merits of internal borrowing i.e. using existing cash to fund expenditure rather than undertaking further borrowing.
- As long term borrowing rates are expected to be higher than rates on the loss of investment income and look likely to be so for the next couple of years or so, authorities may prefer to avoid all new external borrowing in the next financial year in order to maximise savings in the short term.
- The running down of investments also has benefits of reducing exposure to interest rate risk and credit risk.

5.16 Against this background, and with regard to the level of Council investments, caution will be adopted with the 2009/10 treasury operations. The Chief Financial Officer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to the Policy & Resources Committee in the quarterly reports.

5.17 The main sensitivities of the forecast are likely to be the two scenarios below. The Council officers, in conjunction with the treasury consultants, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

- If it were felt that there was a significant risk of a sharp rise in long and short term rates, perhaps arising from a greater than expected increase in world economic activity or further increases in inflation, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

- If it were felt that there was a significant risk of a sharp fall in long and short term rates, due to e.g. growth rates weakening, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term funding will be considered.

Debt Rescheduling

5.18 The introduction of different PWLB rates on 1st November 2007 for new borrowing as opposed to early repayment of debt, and the setting of a spread between the two rates (of about 0.4%-0.5% for the longest period loans narrowing down to 0.25%-0.3% for the shortest loans), has meant that PWLB to PWLB debt restructuring is now much less attractive than before that date. However, significant interest savings may still be achievable through using LOBOs (Lenders Option Borrowers Option) loans and other market loans if these become available after the drying up of their supply during autumn 2008.

5.19 Due to short term borrowing rates being expected to be considerably cheaper than longer term rates, there are likely to be significant opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of their short term nature and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio. Any such rescheduling and repayment of debt is likely to cause a rebalancing of an authority's debt maturities towards a flattening of the maturity profile as in recent years there has been a skew towards longer dated PWLB.

5.20 Consideration will also be given to the potential for making savings by running down investment balances by repaying debt prematurely as short term rates on investments are likely to be lower than rates paid on currently held debt. However, this will need careful consideration in the light of premiums that may be incurred by such a course of action and other financial considerations.

5.21 As average PWLB rates in some maturity periods are expected to be minimally higher earlier on in the financial year than later on, there should therefore be greater potential for making marginally higher interest rate savings on debt by doing debt restructuring earlier on in the year. Any positions taken via rescheduling will be in accordance with the strategy position outlined above.

5.22 The reasons for any rescheduling to take place will include:

- the generation of cash savings and/or discounted cash flow savings but at minimum risk;
- helping to fulfil the strategy outlined above; and
- enhancing the balance of the portfolio (amending the maturity profile and/or the balance of volatility).

5.23 All rescheduling will be reported to the Policy & Resources Committee in the quarterly reports and will be within the limits contained in the Treasury Management Practices.

Investments Strategy

5.24 The Council will have regard to CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes. The Council's investment priorities are: -

(a) the security of capital
and
(b) the liquidity of its investments.

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

5.25 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.

5.26 The Bank Rate started on a downward trend from 5.75% in December 2007 with further cuts of 0.25% in February and April 2008, then 0.5% in October, 1.5% in November, 1% in December and 0.5% in January and February 2009 to reach 1.0%. A further cut of 0.5% is expected during Q1 2009. It is then expected to stabilise at 0.5% until starting to rise gradually with the first increase in Q2 of 2010 and then to be back up to 4.00% during Q1 of 2012.

The Council's treasury consultants advise that Councils should therefore avoid locking into longer term deals while investment rates are down at historically low levels and advise that for 2009/10 clients should budget for an investment return of 1.50% on investments placed during 2009/10.

5.27 Any decisions to lock in investments will need to take cognisance of the medium term cash flow forecasts for the Council.

5.28 Investment activity is reported to the Policy & Resources Committee as part of the quarterly monitoring reports and as part of the annual report on Treasury Management.

Housing Stock Transfer

5.29 Members should note that the Prudential Indicators for 2007/08 include the effect of the HRA debt which has been repaid by the Scottish Government following the Housing Stock Transfer to River Clyde Homes in December 2007.

Amendment to Counterparty Ratings Criteria

5.30 The Council's Counterparty Ratings Criteria use matrices of credit ratings values to determine those counterparties with whom the Council will invest and the maximum periods for such investments. The Criteria are contained in the Treasury Management Practices and are as advised by the Council's treasury consultants and as approved by Committee. The Criteria use the ratings issued by Fitch Ratings and include the effect of the Individual Rating (an assessment of a Bank's individual strength and need for external support).

5.31 Where a UK Bank is nationalised or is substantially supported by the UK Government then the Individual Rating for that Bank is revised by Fitch under their rules and falls below the level acceptable under the Council's Counterparty Ratings Criteria. Under the approved Criteria, the Council would be unable to invest with such a Bank, even though the Bank is supported by the UK Government and so has the same high level of creditworthiness as the UK Government.

5.32 Following advice from the Council's treasury consultants it is proposed to make the following addition to the Council's Counterparty Criteria: "Where a UK Bank has been nationalised or has received substantial support from the UK Government (involving more than 50% ownership) then the maximum investment will be £15 million and the maximum period for an investment will be 364 days."

5.33 The ongoing financial issues with Banks have resulted in most of the Banks having their credit ratings downgraded and under almost constant review. These downgradings, and the fluid nature of the credit ratings as updated news and financial information is issued for each Bank, mean that the list of Counterparties with whom the Council could deal (based on the Criteria in the Treasury Management Practices) has diminished. In this environment, the Council is adopting additional caution in selecting Counterparties.

5.34 As an example of the impact of these changes, the ratings for the Irish Banks have all recently fallen such that the Council would no longer deal with any of the Irish Banks because they do not meet the Council's minimum Counterparty Criteria. The Council previously had investments with Irish Banks but these were all repaid to the Council at maturity and none remain outstanding.

5.35 As a result of the ongoing financial issues, the Council's treasury consultants have recently advised all of their clients to apply a higher standard of credit ratings when assessing counterparties with whom to deal and the period for any deal. The Council are now applying the higher standards proposed by the treasury consultants (which are based on the Criteria in the Treasury Management Practices) but will also continue to exercise additional caution in selecting Counterparties.

Investment Regulations From Scottish Government

5.36 The Scottish Government have, for some time, been proposing to introduce Investment Regulations under Section 40 of the Local Government in Scotland Act 2003. The regulations will widen the range of investments in which the Council can invest, subject to the approval of an Annual Investment Strategy and an Annual Investment Report.

It is understood that the regulations are still in draft form but are proposed for submission to the Scottish Parliament for approval during 2009. Once the regulations have been finalised and approved, any required Investment Strategy or other reports will be submitted for approval.

6.0 IMPLICATIONS

6.1 Legal: None.

6.2 Finance: Adopting the Treasury Strategy for 2009/10 and the following two years will allow a balance to be maintained between opportunities to continue to generate savings for the Council and minimising the risks involved.

Financial Implications: None.

6.3 Human Resources: None.

6.4 Equalities: None.

7.0 CONSULTATIONS

7.1 This report has been produced based on advice from the Council's treasury consultants (Sector Treasury Services Limited).

8.0 LIST OF BACKGROUND PAPERS

8.1 CIPFA - Code of Practice on Treasury Management 2001
CIPFA - Treasury Management in the Public Services – Guidance Notes For Local Authorities Including Police Authorities And Fire Authorities – Second Edition 2006
CIPFA – The Prudential Code for Capital Finance in Local Authorities – Fully Revised Guidance Notes for Practitioners 2007

Appendix 1

TREASURY MANAGEMENT
GLOSSARY OF TERMS

Affordable Capital Expenditure Limit
The amount that the Council can afford to allocate to capital expenditure in accordance with the requirements of the Local Government in Scotland Act 2003 and supporting regulations.

Authorised Limit for External Debt
This is a limit for total Council external debt as set by the Council based on debt levels and plans.

Bank of England
The central bank for the UK with ultimate responsibility for setting interest rates (which it does through the Monetary Policy Committee or "MPC").

Bank Rate
The interest rate for the UK as set each month by the Monetary Policy Committee ("MPC") of the Bank of England. This was previously referred to as the "Base Rate" or the "Repo Rate".

Capital Expenditure
Expenditure on or for the creation of fixed assets that meets the definition of Capital Expenditure under the accounting rules as set-out in the annual Statement of Recommended Practice (SORP) and for which the Council are able to borrow.

Capital Financing Requirement
This is a Prudential Indicator that can be derived from the information in the Council's Balance Sheet. It generally represents the underlying need to borrow for capital expenditure.

CIPFA
CIPFA is the Chartered Institute of Public Finance and Accountancy who produce guidance, codes of practice, and policy documents for Councils.

Consumer Prices Index
The Consumer Prices Index ("CPI") is a means of measuring inflation (as is the Retail Prices Index or "RPI"). The Monetary Policy Committee of the Bank of England set the Bank Rate in order to try to keep CPI at or close to the target set by the Government (currently the target is 2%). The calculation of the CPI includes many items of normal household expenditure but the calculation excludes some items such as mortgage interest payments and Council Tax.

Counterparty
Another organisation involved in a deal i.e. if the Council enters a deal with a bank then the bank would be referred to as the "Counterparty".

Credit Ratings
Credit ratings are indicators produced by a ratings provider (such as Fitch, Moody's or Standard & Poor's) that aim to give an opinion on the relative ability of a financial institution to meet its financial commitments. Credit ratings are not guarantees – they are opinions based on investigations and assessments by the ratings providers and they are regularly reviewed and updated. The Council makes use of credit ratings to determine which counterparties are appropriate or suitable for the Council to make deposits with.

European Central Bank
Sometimes referred to as "the ECB", the European Central Bank is the central bank for the Eurozone and is the equivalent of the Bank of England. The European Central Bank sets interest rates for the Eurozone.

European Investment Bank
Sometimes referred to as “the EIB”, this is the European Union's long-term lending institution from whom Strathclyde Regional Council took out some loans before local government reorganisation in 1996. These loans are now administered by Glasgow City Council to whom the Council makes payments of principal and interest.

Eurozone
The name given to the countries in Europe that have the Euro as their currency. Interest rates in the Eurozone are set by the European Central Bank. The Eurozone is comprised of the following 16 countries: Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, and Spain.

Fed Rate
The interest rate for the US. Rates for the US are set by the Federal Reserve (the central bank for the US and the equivalent of the Bank of England).

Federal Reserve
Sometimes referred to as “the Fed”, the Federal Reserve is the central bank for the US and is the equivalent of the Bank of England. The Federal Reserve sets interest rates for the US.

Fixed Rate Funding/Investments
Funding or investments where the interest rate that applies to payments or receipts of interest on the funding or investments is fixed and does not change.

Flat Yield Curve
A flat yield curve occurs where the yield for long-term investments is the same or similar to the yield for short-term investments – the period of the investment makes no or little difference to the yield on the investment.

Gilt Yields
A gilt yield is the effective rate of return that someone buying a gilt at the current market price will receive on that gilt. Since the market price of a gilt can vary at any time, the yield will also vary.

Gilts
Gilts are bonds (i.e. debt certificates) that are issued (i.e. sold) by the UK Government. When they issue gilts the Government sets the interest rate that applies to the gilt, sets when they will repay the value of the gilt, and it agrees to make interest payments at regular intervals until the gilt is repaid or redeemed. Gilts are traded in the financial markets with the price varying depending on the interest rate applicable to the gilt, when the gilt will be repaid (i.e. when it will mature), on base rate expectations, and on market conditions.

Gross Domestic Product
Gross Domestic Product (“GDP”) is a measure of the output of goods and services from an economy.

Incremental Impact of Capital Investment Decisions
These are Prudential Indicators that reflect the impact on Council Tax of movements in projected and estimated capital expenditure within and between financial years.

Inflation
Inflation is the term used for an increase in prices over time. It can be measured in various ways including using the Consumer Prices Index (“CPI”) or the Retail Prices Index (“RPI”).

Inverted Yield Curve
An inverted or negative yield curve shows long-term investments having lower yields than short-term investments (an investor gets a better yield by investing for a shorter period).

LIBID
This is the London Interbank Bid Rate – an interest rate that is used between banks when they wish to attract deposits from each other.

LIBOR
This is the London Inter Bank Offering Rate – an interest rate that is used as a base for setting interest rates for deals between banks.

LOBO
This is a form of loan that the Council has with some lenders. The term is short for the phrase "Lender Option/Borrower Option".

MPC
The MPC or Monetary Policy Committee is a committee of the Bank of England that meets each month (in a meeting over 2 days) to set the Bank Rate for the UK.

Negative Yield Curve
A negative or inverted yield curve shows long-term investments having lower yields than short-term investments (an investor gets a better yield by investing for a shorter period).

Net Borrowing Requirement
This is the difference between the Council's net external borrowing and its capital financing requirement. Under the Prudential Code the Council's net external borrowing should not, except in the short term, exceed its capital financing requirement. The Net Borrowing Requirement should therefore normally be a negative figure.

Operational Boundary
This is a level of debt set by the Council at lower than the Authorised Limit and which Council debt levels should not normally exceed during normal operations.

Positive Yield Curve
A positive yield curve shows long-term investments having higher yields than short-term investments (an investor gets a higher rate yield for investing for longer).

Prudential Code
Councils are required to comply with the CIPFA Prudential Code for Capital Finance in Local Authorities. These requirements include the production of Prudential Indicators.

Prudential Indicators
Indicators set-out in the Prudential Code that will help Councils to meet requirements in relation to borrowing limits or which will help Councils demonstrate affordability and prudence with regard to their prudential capital expenditure.

PWLB
The Public Works Loan Board is a government agency and part of the Debt Management Office. The PWLB provides loans to local authorities and other specified bodies.

PWLB Rates
The interest rates chargeable by the Public Works Loan Board for loans. The rates for fixed rate loans are determined by the day on which the loan is agreed. The rates to be charged by the PWLB for loans are set each day based on gilt yields at the close of business on the preceding business day.

Ratings
Ratings are indicators produced by a ratings provider (such as Fitch, Moody's or Standard & Poor's) that aim to give an indication of the financial or operational strength of entities including financial institutions and even countries. Ratings are not guarantees – they are opinions based on investigations and assessments by the ratings providers and they are regularly reviewed and updated. The Council makes use of credit ratings to determine which counterparties are appropriate or suitable for the Council to make deposits with.

Repo Rate
This is another name for the Bank Rate as set by the Monetary Policy Committee.

Retail Prices Index
The Retail Prices Index ("RPI") is a means of measuring inflation (as is the Consumer Prices Index or "CPI"). The calculation of the RPI includes most of the same items as the CPI as well as some items not included in the CPI such as mortgage interest payments and Council Tax whilst excluding items that are in the CPI such as charges for financial services.

Sector
Sector Treasury Services Limited who are the Council's treasury management consultants.

Treasury Management in the Public Services: Code of Practice
This is a code of practice for Council treasury management activities that is produced by CIPFA.

Treasury Management Practices (TMPs)
This is a Council document that sets out Council policies and procedures for treasury management as required by the CIPFA "Treasury Management in the Public Services: Code of Practice". The Council also agrees an annual treasury management strategy that is submitted to Committee in accordance with the Treasury Management Practices.

Variable Rate Funding/Investments
Funding or investments where the interest rate that applies to payments or receipts of interest on the funding or investments varies on an agreed basis.

Yield
The yield is the effective rate of return on an investment.

Yield Curve
A graph showing the yield on investments plotted against the maturity period for investments:
- A positive yield curve shows long-term investments having higher yields than short-term investments (an investor gets a higher rate yield for investing for longer).
- A negative or inverted yield curve shows long-term investments having lower yields than short-term investments (an investor gets a better yield by investing for a shorter period).
- A flat yield curve occurs where the yield for long-term investments is the same or similar to the yield for short-term investments – the period of the investment makes no or little difference to the yield on the investment.

Finance Services
Inverclyde Council
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