APPENDIX 11

QUARTERLY TREASURY MANAGEMENT REPORT – MONTH 3

Treasury Management is a complex subject but in summary the core elements of the strategy for 2010/11 are:

- To make use of short term variable rate debt to take advantage of the current market conditions of low interest rates.
- To constantly review longer term forecasts and to lock in to longer term rates through a variety of instruments as appropriate during the year, in order to provide a balanced portfolio against interest rate risk.
- To secure the best short term rates for borrowing and investments consistent with maintaining flexibility and liquidity within the portfolio.
- To invest surplus funds prudently, the Council's priorities being:
    - Security of invested capital
    - Liquidity of invested capital
    - An optimum yield which is commensurate with security and liquidity.
- To approve borrowing limits that provide for debt restructuring opportunities and to pursue debt restructuring where appropriate and within the Council's risk boundaries.

In essence treasury management can always be seen in the context of the classic 'risk and reward' scenario and following this strategy will contribute to the Council's wider Treasury Management objective which is to minimise net borrowing cost short term without exposing the Council to undue risk either now or in the longer in the term.

The main activities undertaken during 2010/11 to date are summarised below:

- Investment returns are expected to decrease from £1M in 2009/10 to an estimated £750,000 in current year as a result of the continued low interest rates and the fact that income earned in 2009/10 included deals arranged before the decline in the markets which have since matured. The average rate achieved to date (0.5%) is inline with the performance indicator of the average 7 day LIBID rate (0.5%).
- In order to balance the fall in investment income we have switched to short term debt which is currently available at lower rates than long term debt due to the depressed market. As a result the average rate for repayment of debt, (the Consolidated Interest Rate – CRI), at 3.24% is lower than that budgeted for but slightly higher than that reported at 31st March 2010 (3.10%) which is in line with reported strategy. It should be noted that the forecast for longer term debt is a steady increase in rates over the next few years, so new long term borrowing will be taken out above the current CRI and therefore an increase in the CRI should be expected.

1. Summary of the Economy and Events in Quarter 1

- The UK continued to emerge from recession but the level of activity remained well below pre-crisis levels. The recovery is as yet fragile; with GDP registering just 0.3% growth in the first calendar quarter of the year. The final revision for 2010 Q1 GDP has been delayed by the ONS due to worries about data accuracy.

- Consumer price inflation remained well above the Bank of England's 2% target level, with a peak of 3.7% being reached in April. Year-on-year CPI for May 2010 was 3.4% and RPI was 5.1%. Temporary effects are thought to lie behind the elevated rate and inflation is expected to fall over the year due to downward pressure from spare capacity. The measure of inflation excluding indirect taxes (CPIY) came down to 1.6% year-on-year. Arguably this is a much more relevant measure of inflationary pressure for forward thinking policy makers, as it excludes changes in the VAT rate and so represents the pressure on the use of resources in the economy more accurately,
- The Bank of England's Monetary Policy Committee maintained the Bank Rate at 0.5% and Quantitative Easing at £200 billion.
- The successful formation of a coalition government dispelled uncertainty surrounding a hung parliament result in May's General Election. The new government's Emergency Budget laid out tough action to address the UK's budget deficit, aiming to eliminate the structural deficit by 2014/15. This is to be achieved through austerity measures – £32 billion of spending cuts and £8 billion of net tax increases. Gilts have benefitted from this decisive plan as well as expected reductions in supply for each year of the forecast. The expected level of spending cuts and tax rises looks to be enough to extinguish the recent concern about inflation expectations. Therefore, rates 'lower for much longer' remained a relevant message.
- The US Federal Reserve kept rates on hold at 0.25% and the European Central Bank maintained rates at 1%. The major ongoing worries in Europe extended from sovereign weakness in the 'PIIGS' nations (Portugal, Italy, Ireland, Greece and Spain), the exposure of the continent's banking sector to the sovereign and corporate debt of these nations and the risk of contagion extending to other countries.

2. Debt Management Quarter 1

Activity within the debt portfolio during the quarter is summarised below, the main change being the addition of £25M new debt being taken out with the PWLB at an interest rate of 4.62% over 40 years:

Capital Expenditure	Balance on 01/04/2010	Debt Maturing or Repaid	New Borrowing	Balance on 30/06/2010	Increase/ (Decrease) in borrowing for Q1
	£000's	£000's	£000's	£000's	£000's
Short Term Borrowing	31,529	(46,715)	46,780	31,594	65
Long Term Borrowing	123,664	(12)	25,000	148,652	24,988
Total Borrowing	**155,193**	**(46,727)**	**71,780**	**180,246**	**25,053**

3. Investment Activity Quarter 1

The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles. The table below summarises activity during the quarter:

Capital Expenditure	Balance on 01/04/2010	Investments Repaid	New Investments	Balance on 30/06/2010	Increase/ (Decrease) in borrowing for Q1
	£000's	£000's	£000's	£000's	£000's
Short Term Investments	29,580	(69,755)	100,805	60,630	31,050
Money Market Funds	10,645	(2,160)	3,195	11,680	1,035
EIB Bonds	6,000			6,000	0
Long Term Investments	36			36	0
Total Investments	**46,261**	**(71,915)**	**104,000**	**78,346**	**32,085**

Counterparty Update

- Following the challenging economic conditions facing Spain, the fiscal challenges ahead for the country, concerns over the effect of rising debt funding costs, and the downgrade of Spain's sovereign rating to AA by Standard and Poor's, the Council has suspended deposits with Spanish banks in Quarter 1 2010 (BBVA and Banco Santander).
- Deposits with Santander UK Plc (a wholly owned subsidiary of Banco Santander) have been restricted to one month as a consequence of the factors outlined above.

The table below summarises the maturity profile of the Council's short term investments together with the long and short term credit ratings of the institutions with which funds have been deposited. The authority does not expect any losses from non-performance by any of its counterparties in relation to its investments.

Country	Current Long Term rating (LCD approach)	Original Long Term rating	Sovereign Rating (LCD approach)	Under 1 Month	1-3 Months	3-6 Months	6-9 Months	Total
UK								
Bank Deposits *	A+	AA+	AAA	29,500	0	2,750	2,000	34,250
Bank Deposits *	A+	AA-	AAA	5,055	2,900	1,000	0	8,955
Bank Deposits *	AA-	AA-	AAA	0	0	0	0	0
Building Societies *	A+	AA-	AAA	5,000	2,000	3,000	0	10,000
Gov't & Local Authority Deposits	AAA	AAA	AAA	7,425	0	0	0	7,425
Money Market Funds	AAA	AAA	AAA	11,680	0	0	0	11,680
Total Investments				**58,660**	**4,900**	**6,750**	**2,000**	**72,310**

* Institutions which have access to the UK Government Credit Guarantee Scheme

4. Compliance with Prudential Indicators

The Council approved a number of indicators at its meeting of the 17th February 2010. These have been reviewed for 2010/11 as detailed below and are reported in accordance with best practice contained in the CIPFA code of practice on Treasury Management and in line with the approved Treasury Management Strategy.

4.1. Authorised Limit and Operational Boundary for External Debt

The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached. The Council's Affordable Borrowing Limit was set at £459M for 2010/11.

The Operational Boundary is based on the same estimates as the Authorised limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit. The Operational Boundary for 2010/11 was set at £444M. The Chief Financial Officer confirms that there were no breaches to the Authorised Limit and the Operational Boundary during the period to 30th June 2010and borrowing at its peak was £257M.

4.2. Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	Limits for 2010/11 %
Upper Limit for Fixed Rate Exposure	100
Compliance with Limits:	Yes
Upper Limit for Variable Rate Exposure	50
Compliance with Limits:	Yes

4.3. Maturity Structure of Fixed Rate Borrowing

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

	Lower Limit	**Upper Limit**	**Actual Fixed Debt as at 30/06/10**	**Average Fixed Rate as at 30/06/10**	**Proportion of Fixed Rate as at 30/06/10**	**Compliance with set Limits?**
	%	**%**	**£000's**	**%**	**%**	
Under 12 Months	0	45	15,504	1.96	13.78	Yes
12 months and Within 24 Months	0	45	5,000	3.72	4.44	Yes
24 Months and within 5 Years	0	50	17,000	3.11	15.11	Yes
5 Years and within 10 Years	0	50	20,000	3.05	17.78	Yes
10 Years and within 20 Years	0	50	0	0.00	0.00	Yes
20 Years and within 30 Years	0	75	10,000	4.68	8.89	Yes
30 Years and within 40 Years	0	75	30,000	4.62	26.67	Yes
40 Years and within 50 Years	0	75	15,000	3.88	13.33	Yes
50 Years and above	0	100	0	0.00	0.00	Yes
			112,504	**3.44**	**100.00**	

4.4. Total principal sums invested for periods longer than 364 days

This indicator allows the Council to manage the risk inherent in investments longer than 364 days. The limit for 2010/11 was set at £50M.

4.5. Ratio of Financing Costs to Net Revenue Stream

This is an indicator of affordability, highlighting the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet borrowing costs. The estimate approved by Council for 2010/11 was 5.55% and at the end of Quarter 1 the actual figure stood at 6.11%.

Authority was delegated to the Executive Director of Resources following consultation with the Cabinet Member for Resources and Workforce Planning to approve any changes to the Prudential Indicators or borrowing limits that will aid good treasury management. A review of this ratio will therefore be undertaken and any amendments will be reported at the next Audit Committee as part of quarterly financial and performance monitoring and in revisions to the Treasury Management strategy.

5. Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council ensures that net external borrowing does not, except in the short term, exceed the CFR in the preceding year, plus the estimates of any additional capital financing requirement for the current and next two financial years. It differs from actual borrowing due to decisions taken to use internal balances and cash rather than borrow. The following table shows the actual position as at 31st March 2010 and shows the estimated position for the current and next two years based on the current approved capital programme:

	Actual	Estimate		
Capital Financing Requirement	**2009/10**	**2010/11**	**2011/12**	**2012/13**
	£M	**£M**	**£M**	**£M**
Balance B/F	**293**	**347**	**341**	**334**
Capital expenditure financed from borrowing	62	3	1	0
Revenue provision for debt Redemption.	(6)	(7)	(6)	(6)
Movement in Other Long Term Liabilities	(2)	(2)	(2)	(2)
Cumulative Maximum External Borrowing Requirement	**347**	**341**	**334**	**326**

The above limits are set to allow maximum flexibility within Treasury Management for example a full debt restructure, actual borrowing is significantly below this as detailed below:

	Balance on 01/04/2010	Balance on 30/06/2010	Estimate		
			2010/11	**2011/12**	**2012/13**
	£000's	**£000'S**	**£000's**	**£000's**	**£000's**
Borrowing	155,193	180,246	215,192	206,769	200,969
Other Long Term Liabilities	71,128	70,752	68,905	66,639	64,314
Total Borrowing	**226,321**	**250,998**	**284,097**	**273,408**	**265,283**

6. Outlook for Quarter 2

As reported by our Advisors (Arlinclose), the outlook for interest rates is as follows:

	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
Official Bank Rate											
Upside risk		0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**0.50**	**0.50**	**0.50**	**0.75**	**1.00**	**1.25**	**1.50**	**2.00**	**2.50**	**2.75**	**3.00**
Downside risk				-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50

The following assumptions have been used in these forecasts:

- The recovery in growth is likely to be slow and uneven, more “W” than “V” shaped and the Bank of England will stick to its lower-for-longer stance on policy rates.
- Gilts will remain volatile, more so in the election’s aftermath.
- The path of base rates reflects the fragile state of the recovering economy and the significantly greater fiscal tightening of the emergency budget. With growth and underlying inflation likely to remain subdued, the Bank will stick to its lower for longer stance on policy rates.
- The potential for downgrades to sovereign ratings has receded, but the negative outlook (S&P) will remain for now.

The movement of interest rates will be closely monitored and Treasury Management activity will respond as required to achieve the core aims of the strategy with an updated report presented at the end of Quarter 2.