HEREFORDSHIRE COUNCIL

AGENDA ITEM NO. X

APPENDIX 1

HEREFORDSHIRE COUNCIL

PRUDENTIAL INDICATORS 2009/10

1. INTRODUCTION

The PIs set out below are recommended by the Prudential Code. However members may prefer additional or alternative indicators that will help with the decision making process.

2. ACTUAL AND ESTIMATED CAPITAL EXPENDITURE

This table takes into account new borrowing for which the government is providing support, government grants, capital receipts, other funding (including s106 receipts) and Prudential Borrowing.

Certain allocations of Government capital funding are not expected until March or April 2009. Such allocations of funding will be added to the Capital Programme and reported as part of the Capital Monitoring process.

	Forecast Outturn 2008/09	Estimated 2009/10	Estimated 2010/11	Estimated 2011/12
Directorate: -	**£'000**	**£'000**	**£'000**	**£'000**
Children's Services	17,315	29,668	30,097	3,655
Resources	4,210	2,910	8,600	-
Deputy Chief Executive	5,564	4,570	10	39
Adult Services	905	551	255	-
Regeneration	11,424	5,904	2,945	-
Environment & Culture	23,809	19,542	13,735	1,554
To be allocated	-	3,821	646	646
	63,227	**66,966**	**56,288**	**5,894**
By funding				
Capital Receipts Reserve	11,016	2,768	1,264	-
Grants and Contributions	23,419	34,154	32,164	3,655
Supported Capital Expenditure (Revenue)	12,751	13,567	13,210	1,200
Prudential Borrowing – allocated	16,041	12,656	9,004	393
Prudential Borrowing – to be allocated	-	3,821	646	646
	63,227	**66,966**	**56,288**	**5,894**

3. RATIO OF FINANCING COSTS TO NET REVENUE STREAM

The net revenue stream is the budget amount to be met from Formula Grant and Council Tax income (the budget requirement). The ratio is the proportion of the budget requirement that relates to the ongoing capital financing costs.

	2008/09 £'000	2009/10 £'000	2010/11 £'000	2011/12 £'000
Net Revenue Stream	131,778	137,718	143,563	147,514
Capital Financing Costs (less contributions)	10,434	13,176	15,100	15,877
Ratio of financing costs to net revenue stream	7.92%	9.57%	10.52%	10.76%

4. CAPITAL FINANCING REQUIREMENT

This indicator represents the underlying need to borrow for a capital purpose. The use of combined anticipated capital receipts and reduction in cash balances may result in actual future debt levels beginning to reduce.

	2008/09 £’000	2009/10 £’000	2010/11 £’000	2011/12 £’000
Capital Financing Requirement (as at 31/3)	158,249	180,697	194,123	186,138

5. AUTHORISED LIMIT FOR EXTERNAL DEBT

The Authorised Limit for external debt represents the absolute maximum level of debt that may be incurred. This limit would only be reached in exceptional circumstances.

	2008/09 £’000	2009/10 £’000	2010/11 £’000	2011/12 £’000
Borrowing	175,000	190,000	210,000	230,000
Other Long Term Liabilities	10,000	10,000	10,000	10,000
Total	**185,000**	**200,000**	**220,000**	**240,000**

6. OPERATIONAL BOUNDARY FOR EXTERNAL DEBT

The Operational Boundary for external debt is the prudent expectation of the maximum level of external debt.

	2008/09	2009/10	2010/11	2011/12
	£'000	**£'000**	**£'000**	**£'000**
Borrowing	152,000	174,000	189,000	189,000
Other Long Term Liabilities	6,000	6,000	6,000	6,000
Total	**158,000**	**180,000**	**195,000**	**195,000**

7. COUNCIL TAX IMPLICATIONS OF THE INCREMENTAL EFFECT OF CAPITAL DECISIONS

This indicator represents the increases in Council Tax resulting from unsupported Prudential Borrowing decisions taken by Council.

Increase in council tax (Band D, per annum) for the Capital Financing costs of the following:	**2009/10**	**2010/11**	**2011/12**
	£ p	**£ p**	**£ p**
Existing Prudential Borrowing allocations	38.18	69.79	96.30
New Prudential Borrowing bids	0.20	3.03	4.70
Total	**38.38**	**72.82**	**101.00**
Existing Prudential Borrowing allocations	(14.70)	(6.58)	(3.64)
New Prudential Borrowing bids	-	-	-
Net Band D Impact	**23.68**	**66.24**	**97.36**

8. TREASURY MANAGEMENT INDICATORS

These are specific indicators which relate to the management of the Treasury Management process.

	2007/08	2008/09	2009/10	2010/11
Upper Limit for Fixed Interest Rate Exposure				
Net principal re fixed rate borrowing / investments	100%	100%	100%	100%
Upper Limit for Variable Interest Rate Exposure				
Net principal re variable rate borrowing / investments	50%	50%	50%	50%

Maturity Structure of new fixed rate borrowing during 2007/08	Upper Limit	Lower Limit
Under 12 Months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

Upper Limit for total principal sums invested for over 364 days	2007/08	2008/09	2009/10	2010/11
	£'000	£'000	£'000	£'000
(per maturity date)	10,000	10,000	10,000	10,000

APPENDIX 2

HEREFORDSHIRE COUNCIL

TREASURY MANAGEMENT STRATEGY 2009/10

1. INTRODUCTION

1.1 The Financial Services Technical Accounting Team is responsible, under the direction of the Director of Resources for the day-to-day management of the Council's treasury management activities. The Treasury Management Strategy for borrowing and Annual Investment Strategy for 2009/10 details the expected activities for the Team in the coming financial year and has been produced in accordance with the Council's approved Treasury Management Policy Statement.

1.2 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 this integrated Treasury Management Strategy.

1.3 The Treasury Management Strategy covers the:

- current treasury portfolio position;
- treasury limits for 2009/10;
- prudential indicators for 2009/10 – 2011/12;
- prospects for the economy and interest rates;
- borrowing strategy;
- debt rescheduling opportunities;
- specified and non-specified investments;
- investment objectives;
- security of capital: the use of credit ratings;
- investment strategy;
- externally managed funds; and
- end of year report.

It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. A local authority is required 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: -

1. increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
2. 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.

2. CURRENT TREASURY PORTFOLIO POSITION

2.1 The Council's treasury portfolio position as at 31st December 2008 is as follows: -

(a) DEBT POSITION	Principal (£)	Borrowing Rate (%)
Public Works Loan Board	103,595,378	4.47
Market Debt *	12,000,000	4.50
Total Debt	**115,595,378**	**4.48**

Estimated Borrowing Requirement 2009/10 – supported borrowing approvals of approximately £13.57 million, plus £16.48 million unsupported borrowing under the Prudential Code (which includes slippage from previous year). In addition refinancing of maturing debt of £255,361 in the year will be required, plus there is the potential for the market debt of £12,000,000 to be recalled and require refinancing.

The Council may, however, decide not to go to the market for loans but use internal balances to fund this requirement in the short term (due to the current credit crunch). This would result in no new external borrowing until 2010/11 and current debts may be settled early where considered prudent, affordable and sustainable to do so.

* The Market debt refers to two LOBO (Lender Option Borrower Option) loans that were taken out at low interest rates fixed for 2 years with the remaining 48 years of the loans currently running at an interest rate of 4.50%

(b) INVESTMENT POSITION	Principal (£)	Rate of Return (%)
Total Investments (Internally Managed)	**50,760,000**	**4.22**

3. TREASURY LIMITS FOR 2009/10

3.1 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 "Affordable Borrowing Limit". The authorised limit represents the legislative limit specified in Section 3 of the Local Government Act 2003.

3.2 The Council must have regard to the Prudential Code when setting their Affordable Borrowing 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 'acceptable'.

3.3 Whilst termed an "Affordable Borrowing 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 affordable borrowing limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

4. PRUDENTIAL INDICATORS FOR 2009/10 – 2011/12

4.1 The following prudential indicators are relevant for the purposes of setting an integrated Treasury Management Strategy.

PRUDENTIAL INDICATOR	2008/09	2009/10	2010/11	2011/12
(1). Budget Setting Indicators				
	£'000	**£'000**	**£'000**	**£'000**
Capital Expenditure	63,227	66,966	56,288	5,894
Ratio of financing costs to net revenue stream				
Net Revenue Stream	131,778	137,718	143,563	147,514
Financing Costs	10,434	13,176	15,100	15,877
Ratio of financing costs to net revenue stream	7.92%	9.57%	10.52%	10.76%

	2009/10	2010/11	2011/12
Incremental effect of Prudential Borrowing	**£ p**	**£ p**	**£ p**
Existing Prudential Borrowing allocations	38.18	69.79	96.30
New Prudential Borrowing bids	0.20	3.03	4.70
Total	**38.38**	**72.82**	**101.00**
Contributions from existing revenue budgets	(14.70)	(6.58)	(3.64)
Net Band D Impact	**23.68**	**66.24**	**97.36**

Capital Financing Requirement (as at 31/3)	**£'000**	**£'000**	**£'000**	**£'000**
Total	158,249	180,697	194,123	186,138

PRUDENTIAL INDICATOR	2008/09	2009/10	2010/11	2011/12
(2). Treasury Management Prudential Indicators				
Authorised Limit for External Debt	**£'000**	**£'000**	**£'000**	**£'000**
Borrowing	175,000	190,000	210,000	230,000
Other Long Term Liabilities	10,000	10,000	10,000	10,000
Total	**185,000**	**200,000**	**220,000**	**240,000**
Operational Boundary	**£'000**	**£'000**	**£'000**	**£'000**
Borrowing	152,000	174,000	189,000	189,000
Other Long Term Liabilities	6,000	6,000	6,000	6,000
Total	**158,000**	**180,000**	**195,000**	**195,000**
Upper Limit for Fixed Interest Rate Exposure	**£ or %**	**£ or %**	**£ or %**	**£ or %**
Net principal re fixed rate borrowing / investments	100%	100%	100%	100%
Upper Limit for Variable Interest Rate Exposure	**£ or %**	**£ or %**	**£ or %**	**£ or %**
Net principal re variable rate borrowing / investments	50%	50%	50%	50%

investments

Maturity Structure of new fixed rate borrowing during 2009/10	Upper Limit	Lower Limit
Under 12 Months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

Upper Limit for total principal sums invested for over 364 days	2008/09 £'000	2009/10 £'000	2010/11 £'000	2011/12 £'000
	10,000	10,000	10,000	10,000

5. PROSPECTS FOR THE ECONOMY & INTEREST RATES

5.1 The Council currently has Sector Treasury Services Limited as its treasury advisers and part of their service is to assist in forming a view on economic trends and the effect on interest rates. This section of the strategy outlines the Council's view of the economy and interest rates based on the advice of its treasury advisers.

Economic Background

5.2 The sub prime crisis of early 2008 was followed by the banking crisis of autumn 2008. The world banking system came near to collapse and governments were forced to recapitalise and rescue their major banks. Lending from banks has fallen, with banks anxious to preserve capital, leading to economic forecasts being sharply reduced and recession being priced into markets. This in turn led to sharp falls in oil and other commodity prices. Inflation, which was running at over 5% in September 2008, is decreasing and recession fears are driving interest rate policies. A co-ordinated global interest rate cut of 0.5% took place on 8th October 2008 followed by further sharp cuts.

5.2.1 UK

- Gross Domestic Product (GDP) growth was already slowing in 2008 before the full impact of the credit crunch was felt. In early 2008 GDP was 2.3%, whereas in the autumn the figure fell back to -0.3% and was then expected to continue to be negative going into 2009.
- 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 throughout the year with forecasts of two million unemployed by the end of the financial year and continuing increases thereafter throughout 2010.
- Notwithstanding the pressures on household finances, consumer spending still continued at a reasonable pace, although the trend was slowing as the year progressed.
- Bank lending came to a virtual standstill in the autumn as the credit crunch tightened its grip and various banks internationally had to be rescued, or supported, by their governments.

- The UK Government and Bank of England supplied massive amounts of liquidity to the banking market in an attempt to reignite longer inter-bank lending.
- The Government took action in September to either supply finance to recapitalise some of the major clearing banks itself; or to require the others to strengthen their capital ratios by their own capital raising efforts. This was done to ensure that banks would be seen to have sufficient reserves to last through the coming recession with its inevitable increase in bad loans.
- 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.
- U.K. equity 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 recession. After the initial concerns about the impact of the credit crunch in the earlier part of 2008 it appeared that the storm had been weathered. The Monetary Policy Committee (MPC) had been very concerned about Consumer Price Index inflation, which had been rising sharply on the back of higher commodity and food prices. 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. The economic data had been indicating a slowing economy for some while but it was not sufficiently weak to force the MPC into cuts. It was the strength of the banking crisis, pre-empted by the collapse of Lehman's in New York that eventually drove the MPC to cut interest rates by 0.5% on October 8th in concert with the Federal Reserve (Fed), the European Central Bank (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% on 6th November, by 1% on 4th December and 0.5% on 8th January to reach 1.5%.
- The London Interbank Bank Offer Rate (LIBOR) spread over Bank Rate has 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 (this is the rate at which banks will lend to one another) has been substantially higher than Bank Rate. 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 24 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.

5.2.2 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 rise in commodity prices.

- The second quarter of 2008/09 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 problem 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 Bros., the 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 for support.
- Eventually even the Asian 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 Fed, ECB and MPC all cutting rates by 0.5% on 8th October. The Fed subsequently cut rates again by 0.5% to 1% on 29th October and again on 16th December to a band of 0.0% to 0.25% in an attempt to stave off the oncoming recession. Inflation was no longer the problem.
- The ECB reduced rates again on 6th November by 0.5% and by its biggest ever cut of 0.75% on 4 December to reach 2.5%.

Interest rate forecast

Base Rate:

5.3 Sector's current interest rate view is that the Bank (base) Rate: -

- Will fall from current levels because of the intensifying global recession;
- Starting 2009 at 2.00%, Bank Rate is forecast to fall to 0.5% in Q1 2009;
- It is then expected to remain there until starting to rise gently up from Q2 2010 until it reaches 4.0% in Q1 2012;
- There is downside risk to these forecasts if the recession proves to be deeper and more prolonged than currently expected.

Long Term Rates:

- The 50 year Public Works Loan Board (PWLB) rate is expected to remain around current levels of about 3.80% - 3.90% until Q2 2010 when it is forecast to rise to 4.00%. The rate then edges up gradually to reach 5.00% at the end of Q1 2012;
- The 25 year PWLB rate is expected to drop to 3.95% in Q1 2009 and stay around there until starting to rise in Q1 2010 and then to eventually reach 5.05% at the end of Q1 2012;
- The 10 year PWLB rate is expected to drop to 2.55% in Q3 2009 but then to start rising again in Q2 2010 to eventually reach 4.85% at the end of Q1 2012;
- The 5 year PWLB rate is expected to fall to a floor of 2.15% during Q3 2009. The rate then starts rising in Q2 2010 to eventually reach 4.60% at the end of Q1 2012.

5.4 Having set the scene in economic terms, the likely impact for interest rates can be assessed and is illustrated in the following tables.

Table 1 Sector Treasury - Interest Rate Forecast

(This table represents the view of the Council's Treasury advisors as at December 2008)

%	Q1 2009	Q2 2009	Q3 2009	Q4 2009	Q1 2010
Base Rate	0.50	0.50	0.50	0.50	0.50
5 Year PWLB	2.50	2.25	2.15	2.15	2.15
10 Year PWLB	3.10	2.75	2.55	2.55	2.55
25 Year PWLB	4.00	3.95	3.95	3.95	4.00
50 Year PWLB	3.85	3.80	3.80	3.80	3.85

Table 2 Summary of Independent Forecasts of Base Rate

(This table represents the views of independent forecasters' views of base rate as at December 2008)

%	2009 Q4	2010 average	2011 average	2012 average
Median	1.00	3.11	3.97	4.49
Highest	4.00	4.70	5.00	5.25
Lowest	0.50	1.00	2.25	3.00

6. BORROWING STRATEGY

6.1 Based upon the prospects for interest rates, there is a range of options available for the borrowing strategy for 2009/10. 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.

6.2 In order to minimise debt interest costs, the main strategy is therefore as follows:

- 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.
- 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 usually borrowing at or near the 50 year period, the council 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 rates of 3.95%, borrowing may be taken at any time in the financial year. A suitable trigger point for considering new fixed rate long term borrowing, therefore, would be 3.95%. 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 25 – 50 basis points below the PWLB target rate if they become available again.

External versus internal borrowing

6.3 The next financial year is expected to be a time of historically low Bank Rate. This opens up an opportunity for the Council to fundamentally review the strategy of undertaking external borrowing.

6.4 Herefordshire Council has investments that it can use to finance the borrowing requirement over the next year so consideration will be given to the potential merits of internal borrowing. As long term borrowing rates are expected to be higher than investment rates and look likely to be so for the next couple of years or so, Herefordshire may prefer to avoid all new external borrowing in the next financial year in order to maximise savings in the short term.

6.5 The running down of investments also has benefits of reducing exposure to interest rate and credit risk.

6.6 Against this background caution will be adopted with the 2009/10 treasury operations. The Director of Resources will monitor the interest rate market and adopt a pragmatic approach to any changing circumstances.

6.7 Sensitivity of the forecast – In normal times the main sensitivities of the forecast are likely to be the two scenarios below. The Council officers, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to any changes:

- ***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.

7. DEBT RESCHEDULING OPPORTUNITIES

7.1 The introduction of different PWLB rates on 1 November 2007 for new borrowing as opposed to early repayment of debt, and the setting of a spread between the two rates (of about 40 – 50 basis points for the longest period loans narrowing down to 25 – 30 basis points for the shortest loans), has meant that PWLB to PWLB debt

restructuring is now much less attractive than before that date because of the small savings compared to premium charges. 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.

7.2 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.

7.3 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.

7.4 The Director of Resources will actively give consideration during the year to undertaking rescheduling in line with the strategy set out in paragraph 6 above.

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

- the generation of cash savings and / or discounted cash flow savings;
- help fulfil the strategy outlined in paragraph 6 above; and
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

8. SPECIFIED AND NON-SPECIFIED INVESTMENTS

8.1 Under CIPFA's Treasury Management Code of Practice and the DCLG's Guidance on Local Government Investments (issued in March 2004) the Council is required to formulate a strategy each year regarding its investments.

8.2 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 headings of **Specified Investments** and **Non-Specified Investments** as detailed in **Annex A**.

8.3 This Annex sets out:

- The procedures for determining the use of each category of investment (advantages and associated risk), particularly if the investment falls under the category of "non-specified investments."

- The maximum periods for which funds may be prudently committed in each category.

- If non-specified investments are to be used, whether prior professional advice is to be sought from the Council's treasury advisors (Sector Treasury Services Ltd).

8.4 With regard to the Council's Joint Ownership of West Mercia Supplies and the level of balances held by this organisation; the Council may, if deemed in the best interest of prudent management of the West Mercia business undertake transactions pertaining to foreign currencies, such as foreign exchange deals and investments. Such dealings must have **relevance to the course of business of West Mercia Supplies**. These dealings will be classified as **non-specified** as they are not sterling denominated.

9. INVESTMENT OBJECTIVES

9.1 The general policy objective for Herefordshire Council is the prudent investment of its treasury balances. The Council's investment priorities are:

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

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

9.2 The borrowing of monies purely to invest or on-lend and make a return is unlawful and the Council will not engage in such activity.

10. SECURITY OF CAPITAL: THE USE OF CREDIT RATINGS

10.1 The Council uses credit ratings published by *Fitch Ratings* and *Moody's Investors Service* to establish the credit quality of counterparties and investment schemes. The Council has also determined the minimum long-term, short-term and other credit ratings it deems to be "high" for each category of investment in conjunction with its Treasury Management advisor.

Monitoring of credit ratings:

10.2 All credit ratings will be monitored monthly: The Council has access to Fitch and Moody's Investors Service credit ratings and is alerted to changes from its Treasury Management advisor.

10.3 If a counterparty's or investment scheme's rating is downgraded with the result that it no longer meets the Council's minimum criteria, the further use of that counterparty/investment scheme as a new investment will be withdrawn immediately. Any intra-month credit rating downgrade, which the Council has identified, that affects the Council's pre-set criteria will also be similarly dealt with.

11. INVESTMENT STRATEGY

11.1 The Director of Resources manages the Council's investment portfolio. Investments managed by the in-house team are generally temporary in nature and short-term. All decisions are made in the light of the Council's forecast cash flow requirements.

11.2 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 2009 with further cuts expected during Q1 2009. It is then expected to stabilise at 0.50% until starting to rise gradually with the first increase in Q2 2010 and then to be back up to 4.00% during Q1 2012. The Council will therefore avoid locking into longer term deals while investment rates are down at historically low levels.

12. END OF YEAR REPORT

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

ANNEX A

SPECIFIED INVESTMENTS

All specified investments will be sterling-denominated with maturities up to a maximum of 1 year.

Investment	Security / Credit Rating	Circumstance of use
Debt Management Agency Deposit Facility (DMADF)	Govt-backed	In-house
Term deposits with the UK government or with UK local authorities *(i.e. deposits with local authorities as defined under Section 23 of the 2003 Act)*	High security although LAs not credit rated.	In-house
Term deposits with credit-rated deposit takers *i.e. deposits with banks and building societies, (including callable deposits),* with maturities up to 1 year	Yes-varied *Minimum rating "A" Long-term and "F1" Short-term (or equivalent)*	In-house
Certificates of Deposit issued by credit-rated deposit takers *(i.e. a certificate issued for deposits made with a bank or building society, who agree to pay a fixed rate of interest for the specified period of time and repay the principal at maturity)* up to 1 year. *Custodial arrangement required prior to purchase*	Yes-varied *Minimum rating "F1+" Short-term (or equivalent)*	External fund manager
Gilts: up to 1 year *(a fixed interest security issued or secured by the British Government)* *Custodial arrangement required prior to purchase*	Govt-backed	Buy and hold to maturity: to be used in-house after consultation with Treasury Management advisor
Money Market Funds *(a AAA credit rated collective investment scheme such as a mutual fund or a unit trust, as defined in Statutory Instrument 2004 No. 534, that invests exclusively in money market securities)*	Yes-varied *Minimum AAA credit rated*	In-house after consultation with Treasury Management advisor
Forward deals with credit rated banks and building societies < 1 year *(i.e. a deal negotiated before the deposit is paid, with the negotiated deal period plus period of deposit < 1 year)*	Yes-varied *Minimum rating "A" Long-term and "F1" Short-term (or equivalent)*	In-house

ANNEX A

NON-SPECIFIED INVESTMENTS

All investments listed below must be sterling-denominated

Investment	Security / Minimum credit rating	Circumstance of use	Max % of overall investments	Maximum maturity of investment
Term deposits with credit rated deposit takers (banks and building societies) with maturities greater than 1 year	YES-varied *Minimum rating "AA-" Long-term and "F1" Short-term (or equivalent) Support 1,2 or equivalent*	In-house	25%	5 years
Certificates of Deposit with credit rated deposit takers (banks and building societies) with maturities greater than 1 year *Custodial arrangement required prior to purchase*	YES-varied *Minimum rating "AA" Long-term and "F1+" Short-term (or equivalent)*	In-house after consultation with Treasury Management advisor	20%	5 years
Callable deposits with credit rated deposit takers (banks and building societies)	YES-varied *Minimum rating "AA-" Long-term and "F1" Short-term (or equivalent) Support 1,2 or equivalent*	In-house after consultation with Treasury Management advisor	20%	5 years in aggregate
Range trade deposits with credit rated deposit takers (banks and building societies)	YES-varied *Minimum rating "AA-" Long-term and "F1" Short-term (or equivalent) Support 1,2 or equivalent*	In-house after consultation with Treasury Management advisor	20%	5 years
Snowballs with credit rated deposit takers (banks and building societies)	YES-varied *Minimum rating "AA-" Long-term and "F1" Short-term (or equivalent) Support 1,2 or equivalent*	In-house after consultation with Treasury Management advisor	20%	5 years
Gilt Funds and other Bond Funds*.** *[These are open-end mutual funds investing predominantly in UK govt gilts and corporate bonds. These funds do not have any maturity date. These funds hold highly liquid instruments and the Council's investments in these funds can be sold at any time.]*	*Minimum rating "AA-"*	External fund manager only subject to guidelines and parameters agreed with them	20%	10 years

ANNEX A

Investment	Security / Minimum credit rating	Circumstance of use	Max % of overall investments	Maximum maturity of investment
UK government gilts *Custodial arrangement required prior to purchase*	Govt backed	Buy and hold to maturity: in-house after consultation with Treasury Management advisor	20%	10 years (but also including the 10 year benchmark gilt)
Treasury bills [*Government debt security*] *Custodial arrangement required prior to purchase*	Govt backed	In-house after consultation with Treasury Management advisor	20%	5 years
Forward deposits with credit rated banks and building societies for periods > 1 year (i.e. negotiated deal period plus period of deposit)	Yes-varied *Minimum rating "AA-" Long-term and "F1" Short-term (or equivalent) Support 1,2 or equivalent*	In-house after consultation with Treasury Management advisor	20%	5 years
Deposits with unrated deposit takers (banks and building societies) but with unconditional financial guarantee from HMG or credit-rated parent institution: any maturity	Not rated in their own right, but parent must be rated. *Minimum rating for parent "AA-" Long-term and "F1" Short-term (or equivalent) Support 1,2 or equivalent*	In-house	20%	1 year
Bonds issued by a financial institution that is guaranteed by the UK Government (as defined in Statutory Instrument 2004 No. 534) *Custodial arrangement required prior to purchase*	AAA / Govt guaranteed	Buy and hold to maturity: in-house after consultation with Treasury Management advisor	20%	10 years
Bonds issued by multilateral development banks (as defined in Statutory Instrument 2004 No. 534) *Custodial arrangement required prior to purchase*	AAA / Govt guaranteed	Buy and hold to maturity: in-house after consultation with Treasury Management advisor	20%	10 years

APPENDIX 3

HEREFORDSHIRE COUNCIL

TREASURY MANAGEMENT POLICY STATEMENT

Statement of Purpose

1. Herefordshire Council adopts the key recommendations of CIPFA's *Treasury Management in the Public Services: Code of Practice* and: -

   - will put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of its treasury management activities
   - will make effective management and control of risk the prime objectives of its treasury management activities
   - acknowledge that the pursuit of best value in treasury management, and the use of suitable measures of performance measures, are valid and important tools to employ in support of business and service objectives;
   - that, within the context of effective risk management, will ensure that its treasury management policies and practices reflect the pursuit of best value;
   - formally adopts the four clauses listed in Section 5 of the Code, being the recommendations of the Code in relation to effective treasury management as described in this report.
   - will adopt a treasury management policy statement as recommended in Section 6 of the Code
   - will follow the recommendations in Section 7 of the Code concerning treasury management practice statements.

Definition of Treasury Management

2. Herefordshire Council defines its treasury management activities as: -

   'The management of the organisations cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.'

Policy Objectives

3. Herefordshire Council regards the successful identification, monitoring and control of risk as the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Council.

4. Herefordshire Council acknowledges that effective treasury management will provide support towards the achievement of its business and services objectives. It is therefore committed to the principles of achieving best value in treasury management, and to employing suitable performance measurement techniques within the context of effective risk management.

Delegation & Reporting

5. Herefordshire Council retains responsibility for approving the Council's Treasury Management Policy and will consider amendments to it on the advice of Cabinet.

6. Herefordshire Council delegates responsibility for approving an annual Treasury Management Strategy to Cabinet as the mechanism for implementing the Treasury Management Policy.

7. Herefordshire Council delegate's responsibility for monitoring that treasury management activity is in accordance with the approved policies, strategies and practices to Cabinet.

8. Herefordshire Council delegates responsibility for the development and maintenance of suitable Treasury Management Practice Statements to the Director of Resources.

9. Herefordshire Council delegates responsibility for the administration of treasury management decisions to the Director of Resources who will act in accordance with the approved Treasury Management Policy Statement, Treasury Management Strategy and Treasury Management Practice Statements. If the Director of Resources is a member of CIPFA, he/she shall also comply with CIPFA's Standard of Professional Practice on Treasury Management.

10. Herefordshire Council will receive reports from the Director of Resources on its treasury management policies, strategy, practices and activities, including, as a minimum, an annual strategy in advance of the year and an annual report after its close, in the form prescribed in the Council's Treasury Management Practice Statements.

APPENDIX 4

HEREFORDSHIRE COUNCIL

STATEMENT ON MINIMUM REVENUE PROVISION 2009/10

1. Introduction

Local Authorities are required to charge to their revenue account for each financial year Minimum Revenue Provision (MRP) to account for the cost of their debt in that year. Under the **The Local Authorities (Capital Finance and accounting) (England) (Amendment) Regulations 2003 (the 2003 Regulations)** set out the method council's had to follow in calculating MRP. **The Local Authorities (Capital Finance and accounting) (England) (Amendment) Regulations 2008** replaces these detailed rules for calculating MRP with a requirement to calculate an amount of MRP which they consider to be prudent.

2. Annual MRP Statement

The Secretary of State recommends that before the start of each financial year that a local authority prepares a statement of its policy on making MRP in respect of that financial year and submits it to the full council.

3. Options for making 'Prudent Provision'

3.1 There are four options for Prudent Provision set out in the guidance;

Option 1 - Regulatory

For debt which is supported by the Government through Revenue Support Grant (RSG), authorities may continue to use the formulae under the 2003 Regulations, as RSG debt support is calculated in that way. This includes applying an adjustment (the Item A adjustment), which reduces the charge back to the former credit ceiling accounting methodology.

Option 2 - CFR method

This is similar to option 1, but just uses the CFR and doesn't apply the full formula, including the Item A adjustment. Under this option the annual repayment would be higher.

Option 3 - Asset Life Method

For new borrowing under the prudential system there are 2 options in the guidance. The first is to make provision over the estimated life of the asset for which the borrowing is undertaken. This is a simpler alternative to the use of depreciation accounting (Option 4) and the council has already been applying to do this on a voluntary basis. This can either be on an equal instalment method or an annuity basis.

Option 4 - Depreciation method

An alternative to Option 3 is to make provision in line with depreciation accounting. Although this would follow standard rules for depreciation accounting there would have to be some exceptions, for example, that MRP would continue until the provision is equal to the original debt and then cease.

3.2 MRP normally commences in the year following the one in which expenditure was incurred. However, the guidance allows for an exception to this for options 3 and 4 when a new asset is provided, in which case the MRP would not have to be charged until the year following the year in which the asset first becomes operational.

4 MRP Policy 2009-10

4.1 In line with the guidance produced by the Secretary of Statement the proposed policy for the 2009-10 calculation of MRP is as follows;

4.2 Borrowing supported through the RSG grant system will be repaid in accordance with the 2003 Regulations.

4.3 Prudential borrowing will be repaid over the life of the asset on an equal instalment basis commencing in the year following the year in which the asset first becomes operational.

4.4 For expenditure under Regulation 25(1)(b), loans and grants towards capital expenditure by third parties, prudential borrowing will be repaid over the life of the asset in relation to which the third party expenditure is incurred.