

THE EXECUTIVE

16 FEBRUARY 2010

REPORT OF THE CORPORATE DIRECTOR OF FINANCE AND COMMERCIAL SERVICES

This report is submitted under Agenda Item 14. The Chair will be asked to decide if it can be considered at the meeting under the provisions of Section 100B(4)(b) of the Local Government Act 1972 as a matter of urgency in order to avoid any delay in the setting of the Annual strategy as part of the Council's overall budgetary framework for 2010/11.

Title: Treasury Management Annual Strategy and the Council's Prudential Indicators 2010/11	For Decision
<p>Summary</p> <p>This report deals with the Treasury Management Annual Investment Strategy Statement, Treasury and Prudential Indicators, Annual Investment Strategy and borrowing limits, in compliance under section 15 (1) (a) of the Local Government Act 2003 for consideration by the Executive.</p> <p>The production and approval of a Treasury Management Annual Strategy Statement and Annual Investment Strategy are requirements of the Council under Section 15(1) of the Local Government Act 2003. It is also a requirement of the act to set an authorised borrowing limit for the forthcoming financial year.</p> <p>The Local Government Act 2003 also requires the Council to have regard to the Prudential Code, and to set prudential indicators which take into account the Council's capital investment plans for the next 3 years.</p> <p>Wards Affected: None</p>	
<p>Recommendation(s)</p> <p>The Executive is asked to recommend the Assembly to approve:</p> <ul style="list-style-type: none">(i) The Treasury Management Strategy Statement for 2010/11 and, in doing so:<ul style="list-style-type: none">a) To agree an authorised borrowing limit of £200million for 2010/11 as the statutory limit determined under section 3 (1) of the Local Government Act 2003, as detailed in section 4 of the report;b) To adopt the he Borrowing Strategy and Debt Rescheduling Strategy for 2010/11 as detailed in sections 7 and 8 respectively of the report;c) To adopt the Minimum Revenue Provision Strategy for 2010/11 which sets out the Council's policy on repayment of debt, as detailed in section 9 of the report;d) To adopt the Annual Investment Strategy for 2010/11, which outlines the investments that the Council may use for the prudent management of its investment balances and benchmarks set for external managers, as set out in	

section 10 of the report;

- e) To agree the Treasury Management Indicators and Prudential Indicators for 2010/11 as set out at Appendix A to this report; and
- f) To agree the Treasury Management Practices and Scheme of Delegation as set out at Appendix D and the Reporting Arrangements at Appendix E to this report.

Reason(s)

To ensure that the Council meets the requirements of the Local Government Act 2003.

Implications

Financial

The aim of this Treasury Management Strategy is to maximise the Council's financial resources. Detailed financial considerations are considered throughout this document.

Legal

Local authorities have power to invest under section 12 Local Government Act 2003 for any purpose relevant to their statutory functions or for the purposes of the prudent management of their financial affairs. The Council is required under the 2003 Act to have regard to any relevant guidance. In this regard the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 requires local authorities to have regard among other things to the Prudential Code for Capital Finance in Local Authorities and 'Treasury Management in the Public Services Code of Practice and Cross Sectoral Guidance Notes.

This report sets out a proposed strategy for investment in accordance with the legislation and codes of practice referred to. Members will note that the strategy includes an element of borrowing. In relation to borrowing section 3 Local Government Act 2003 requires local authorities to determine and review how much it can afford to borrow (the affordable borrowing limit). The proposed level of borrowing is within the authorised limit. In relation to capital projects local authorities are also required to charge to a revenue account a minimum amount (minimum revenue provision) for that financial year and may charge any amount in addition to the minimum in respect of the financing of capital expenditure incurred by the local authority (Local Authorities (Capital Finance and Accounting) (England) Regulations 2003).

Risk Management

This report has risk management issues for the Council, e.g. the risk that a counterparty could cease trading or that interest rates would fall adversely. The mitigation of these is contained in this report.

Staffing

No specific implications

Customer Impact

No specific implications

Safeguarding Children

No specific implications

Property / Assets No specific implications		
Options Appraisal Not applicable.		
Head of Service John Hooton	Title: Strategic Finance Controller	Contact Details: Tel: : 020 8227 2801 Fax: 020 8227 2770 E-mail: john.hooton@lbbd.gov.uk
Report Author Miriam Adams	Title: Treasury & Pensions Manager	Contact Details: Tel: 020 8227 2770 Fax: 020 8227 2770 E-mail: Miriam.adams@lbbd.gov.uk

1. Treasury Management Strategy for 2010/11

- 1.1 The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.
- 1.2 The Act therefore requires local authorities to set out their treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act). This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.
- 1.3 The 2010/11 strategy covers:
 - The Legislation and changes to Legislation;
 - Revised Treasury Management Policy;
 - The treasury limits and indicators;
 - The current treasury position and borrowing position;
 - Prospects for interest rates;
 - The borrowing strategy and Borrowing Requirement;
 - The policy on borrowing in advance of need and debt rescheduling strategy;
 - The Minimum Revenue Provision strategy;
 - The Annual Investment Strategy and Investment Policies;
 - Security of Capital and creditworthiness policy;

- Statutory Requirements on Reporting of Treasury Management;

2. Legislation and Changes in Legislation

- 2.1 2009 has seen a number of changes to Treasury Management legislation and guidance. CIPFA issued an amended CIPFA Treasury Management in the Public Services Code of Practice (the Code) and Cross-Sectoral Guidance Notes.
- 2.2 The Revised CIPFA Treasury Management Code of Practice 2009 Council's are required to formally adopt the resulting Treasury Management Practice Statements included in **Appendix D** to this report. The original 2001 Code has been adopted annually in the Council's Treasury Management Strategy.

The revised Code now requires the Council's Treasury Management Strategy to be approved annually by the full Council. In addition there will be a mid year report to enable member scrutiny. Functions have also to be clearly delegated as required. This has been included in **Appendix E** to this report.

2.3 The Revised CIPFA Prudential Code

A revised Prudential Code was also issued by CIPFA. The authorised limit for external debt, operational boundary for external debt and actual debt indicators which were previously reported as part of the Prudential Indicators have been moved from being Prudential Indicators to being Treasury Indicators.

2.4 Revised Investment Guidance

The Department of Communities and Local Government has recently completed a consultation exercise on draft revised investment guidance which is to result in the issue of further investment guidance to take effect from 1 April 2010. Further details on this will be reported to members in the mid year treasury management report.

2.5 The Balanced Budget Requirement

It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This means that increases in capital expenditure must be limited to a level whereby charges to revenue caused by borrowing and any increases in running costs are limited to a level which is affordable within the projected income of the Council for foreseeable future. This is confirmed in the Council Tax report.

3. The Revised Treasury Management Policy

- 3.1 The Council defines the policies and objectives of its treasury management activities as the management of investments, the authority's cash flows, its banking, money and capital market transactions, the effective control of the risks associated with those activities, and the pursuit of optimum performance with those risks.
- 3.2 The Council regards the successful identification, monitoring and control of risk to be 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.

- 3.3 The Council is aware that effective treasury management will provide support towards the achievement of its business and service 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.
- 3.4 It is a statutory requirement that this Council may only borrow in sterling except with the consent of HM Treasury.

4. Treasury Limits and Indicators for 2010/11 to 2012/13

- 4.1 There are a number of treasury indicators which previously formed part of the Prudential Code, but which the new guidance has linked to the Treasury Management Code and guidance. Local authorities are still required to “have regard” to these treasury indicators.

The key treasury indicators which are still part of the Prudential Code are:

- Authorised limit for external debt;
- Operational boundary for external debt; and
- Actual external debt.

In addition the following treasury management indicators are part of the Treasury Management Code:

- Upper limits on fixed interest and variable interest exposures;
- Upper and lower limits to the maturity structure of borrowing; and
- Upper limits of the total of principal sums invested longer than 364 days.

- 4.2 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 ‘Authorised Limit’ represents the legislative limit specified in the Act.
- 4.3 It is proposed that the ‘Authorised Limit’ remain at £200m for the years 2010/11 – 2012/13. The capital programme report that is also being considered on this agenda is proposing a total capital programme that will lead to a borrowing requirement of around £130m by the end of 2012/13. As this is a legal limit, sufficient headroom has been provided to ensure that any major capital investment projects where financing has yet to be finalised, are not restricted by this statutory limit. This limit would cover any short-term borrowing for cash flow purposes as well as long term borrowing for capital projects, finance leases, PFI initiatives as well as any unforeseen incidences where expected capital receipts are not forthcoming due to unexpected economic factors.
- 4.4 The code also requires the local authority to set an operational limit for the 2010/11 financial year and the following two financial years for its total external debt. The operational limit is the level at which the Council would actually need to borrow in any one year to meet its capital financing requirements for the capital programme.

A borrowing limit would apply to both short-term and long term borrowing, and would be used to address cash flow issues in the short-term and capital financing issues in the longer term.

Full details of the Council's Treasury Indicators have been included in **Appendix A** to this document.

5. Current Portfolio Position

5.1 Investments and borrowing balances

The table below shows the Council's current treasury portfolio position at 31 December 2009:

	31 December 2009	Average rate of return/payment
	£ Million	%
Investments		
Council in House Team	26.61	2.83
Scottish Widows	18.72	3.07
Investec Asset Management	37.96	1.19
Royal Bank of Scotland (RBS)	15.0	3.10
TOTAL INVESTMENTS	98.29	2.55
Borrowing		
Fixed rate Funding PWLB	30.0	4.06
Market	20.0	3.98
TOTAL BORROWING	50.0	4.02

5.2 The sum invested broadly represents the reserves, provisions and balances that the Council holds together with the impact of any difference between the collection of income and expenditure (working capital). From 1 April 2010, the pension fund cash currently managed by the Council will no longer be reported as part of the Council's balance.

5.3 Based on its cash flow forecasts, the Council anticipates its fund balances by 31st March 2010 to be approximately £110 million. This is based upon the 2009/10 capital programme expenditure profile and both agreed and forecast use of reserves and other balances.

6. Prospects for Interest Rates

6.1 The level of, and fluctuations in interest rates, are a key consideration for any treasury management strategy. In 2009/10, bank rate remained unchanged. This position is expected to continue till Q3 2010/11 with expectations tending towards a further 1.0% increase in the later part of 2011 and 2% increase in 2011/12. The Council has ensured that sufficient provision has been made in the Medium Term Financial Strategy to cover this reduction in income for 2010/11. The Council invests its portfolio throughout the year, and the level of interest rates determines the interest receipts that are generated to support ongoing revenue expenditure. The Council has set its budget based on a return of 1.5%. In order to meet this target, the Council will avoid locking into longer term deals while investment rates

are historically low unless exceptionally attractive rates are available which make longer term deals worthwhile.

- 6.2 There is a downside risk to any forecast provided for 2010/11 if the recovery from the recession proves to be weaker and slower than currently expected. To arrive at an expectation of interest rates for 2010/11, and beyond, a number of judgements and assumptions are made; in addition this involves a high degree of uncertainty.
- 6.3 The Council has appointed Sector Treasury Services as treasury adviser to the Council, part of the service provided assists the Council in formulating a view on interest rates. **Appendix B** draws together a number of current City forecasts for short-term, variable and longer fixed interest rates.

7. Borrowing Strategy and Borrowing Requirement

- 7.1 The decision to borrow is a treasury management decision and is taken by the Chief Financial Officer under delegated powers of the Council's constitution. The key objective of the Council's borrowing strategy is to secure long term funding for capital projects at borrowing rates that are as low as possible.

7.2 Borrowing Objectives

The Council will look to reducing the revenue cost of borrowing to its minimum by appraising new sources of finance and loan instruments in order to achieve minimum risk while having regard to the maturity profile of loans. The authority will consider borrowing fixed rate funds when interest rates are low and variable rates when borrowing or investment cash rates are high and expected to go lower. When the market becomes favourable to borrow the Council may have to fund known capital needs ahead of that need in order to take advantage of lower fixed term rates and market opportunities.

7.3 Borrowing Options

The option to borrow is always a financing option. The decision to borrow is being taken in consultation with our expert treasury advisors. A mix between Public Works Loans Board (PWLB) and money market loans is recommended by our treasury management advisers.

With current investment rates still low, in contrast to current borrowing rates, the Council can also consider the use of its internal investments as an alternative to borrowing, as returns on investments will be low in 2010/11.

7.4 Portfolio Mix

The Council's commenced borrowing in 2008/09, the Council will continue to seek the advice of its treasury management advisers on the best portfolio mix. It is advised that at any one point in time the Council should have a portfolio where no more than 10% of its debt matures in any one year. As the Council has only recently started to borrow, this objective will only be achieved as a portfolio of debt has been built up (i.e. the Council has more than 10 loans on its books). The Chief Financial Officer monitors the portfolio mix on a periodical basis.

7.5 Risk Evaluation

The Council will continue to borrow in tranches as the opportunities arise in the market in order to reduce financing risk.

7.6 Portfolio Life

In any debt portfolio there will be a range of maturities out as far as 70 years. As part of the proactive management of the debt portfolio these loans will be considered for debt restructuring through monitoring and where a financial benefit can be made, debt will be restructured within acceptable risk parameters in the treasury management strategy. The debt maturity profile will not stay static because when opportunities arise they are taken in order to reduce the council's underlying financing costs which will impact on the revenue budget.

7.7 The table below indicates the estimated range of total long term borrowing requirement (cumulative) from 2010/11 to 2012/13:

Borrowing Requirement	2009/10 £m Estimate	2010/11 £m Estimate	2011/12 £m Estimate	2012/13 £m Estimate
CUMULATIVE TOTAL	80 - 90	105-115	120-130	125-135

7.8 The borrowing rate forecast for 2010/11 from Sector is as follows:

- The 50 year PWLB rate is expected to fluctuate by 0.05% between quarters 1 and 2, while Q3 and Q4 is expected to fluctuate by 0.15% and 0.10%. Q1 4.70% , Q2 4.75%, Q3 4.90% and Q4 5.00%;
- Similarly, the 25 year PWLB rate is expected to increase progressively from 4.60% to 5.0% in Q4;
- The 10 year PWLB rate is expected to rise from 4.05% in Q1 2010 to 4.15% in Q2, 4.30% in Q3 and 4.45% in Q4;
- The 5 year PWLB rate is expected to rise progressively from 3.05% in Q1 to 3.40% in Q3 to reach 3.60% in Q4;
- Rates are expected to gradually rise during the year;
- Variable rate borrowing is expected to be cheaper than long term borrowing, the council will consider but amount borrowed will not exceed the treasury limits for variable borrowing;
- The forecast indicates that the borrowing strategy for 2010/11 should be to take long term borrowing at the start of the financial year because rates are expected to rise during the year; and
- There is expected to be little difference between 25 year and 50 year rates so therefore loans in the 25-30 year periods could be seen as being more attractive than 50 year borrowing as the spread between PWLB new borrowing and early repayment rates is considerably less. This maximise the potential for debt rescheduling and allow the council to rebalance its debt maturity profile.

7.9 In summary, considering the factors set above, the recommended borrowing strategy:

- Borrowing long term will be done at the early part of the financial year should rates remain in line with expectations;
- Cash balances, not identified for longer term investments, may be used to finance capital expenditure on a temporary basis as current interest rates are such that returns on cash balances are still considerably low in comparison to borrowing rates;

- PWLB 25 year borrowing rather than 50 year borrowing will be considered as the spread between PWLB new borrowing as early repayment rates is considerably less; and
- Borrowing will be in fixed rate market loans at 25 – 50 basis points below the PWLB target rate should rates remain in line with expectations.

7.10 External and Internal Borrowing

The revised Prudential Code paragraph 73 now requires each authority to explain its policy on gross and net debt, where there is a significant difference between them.

Comparison of gross and net debt positions at year end

	2008/09	2009/10	2010/11	2011/12	2012/13
	Actual	Estimate	Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m
Actual External Debt (gross)	50	80	110	125	130
Cash Balances	123	110	89	98	105
Net Cash (debt)	73	30	(21)	(27)	(25)

Pension fund cash no longer included in council's balance for 2010/11

- The Council currently has a difference between gross debt and net debt (after deducting cash balances) of £39.8m
- The general aim of this treasury management strategy is to reduce the difference between the two debt levels over the next three years in order to reduce the credit risk incurred by holding investments.
- The Council during the financial year will carefully consider the difference between borrowing rates and investment rates to ensure that the Council obtain value for money.
- Low bank rates are still expected for most of 2010/11 and over the next two years in comparison to external borrowing rates this means the council will continue to utilise internal borrowing rather than external borrowing as the opportunity arises.
- Short-term savings as a result of avoiding new long term external borrowing in 2010/11 will also be considered in conjunction against the potential for incurring additional long term extra costs by delaying unavoidable new external borrowing until later years when PWLB long term rates are forecast to be significantly lower.

8. Borrowing in Advance of need and Debt Rescheduling Strategy

8.1 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance of need will be considered carefully by the S151 Officer to ensure that this is in line with the financing of the capital programme (the "capital financing requirement"), that value for money can be demonstrated and that the Council can ensure the security of such funds.

In coming to a decision whether borrowing will take place in advance of need the Council will:

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need;
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered;
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;
- consider the merits and demerits of alternative forms of funding; and
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.

8.3 The key decision in debt restructuring will be the ability to demonstrate value for money. The decision to reschedule will be taken by the S151 Officer under delegated powers of the Council's constitution and in consultation with the council treasury management advisers.

Significant interest savings may still be achievable through using Lenders Option Borrowers Option (LOBOs) loans and other market loans in rescheduling exercises.

8.4 Due to the short-term borrowing rates being expected to be considerably cheaper than long 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 be considered in light of their short-term nature and likely cost of refinancing these short-term loans once they mature. The Council is aware that any such rescheduling and repayment of debt is likely to cause a flattening of the Council's maturity profile

9. Minimum Revenue Provision (MRP) Strategy

9.1 Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. It would be impractical to charge the entirety of such expenditure to revenue in the year in which it was incurred therefore such expenditure is spread over several years in order to match the years over which such assets benefit the local community through their useful life. The manner of spreading this cost is known as an annual "Minimum Revenue Provision". There is no requirement for the Council to charge MRP where the Capital Financing Requirement is nil or negative at the end of the preceding year. In addition the share of the Housing Revenue Account CFR is not subject to an MRP charge.

9.2 There are four main options recommended in the guidance under which a local authority may consider its MRP to be prudent:

Option 1: Regulatory Method

Under the previous MRP regulations, MRP was set at a uniform rate of 4% of the adjusted CFR (i.e. adjusted for "Adjustment A") on a reducing balance method (which in effect meant that MRP charges would stretch into infinity). Guidance recommends that this approach must continue for all capital expenditure incurred in years before the start of this new approach. It may also be used for new capital expenditure up to the amount which is deemed to be supported through the annual borrowing allocation.

Option 2: Capital Financing Requirement Method

This is a variation on option 1 which is based upon a charge of 4% of the aggregate CFR without any adjustment for Adjustment A, or certain other factors which were brought into account under the previous statutory MRP calculation. The CFR is the measure of an authority's outstanding debt liability as depicted by their balance sheet. The Council went into debt in 2008/09.

Option 3: Asset Life Method.

This method may be applied to most new capital expenditure, including where desired that which may alternatively continue to be treated under options 1 or 2.

Under this option, it is intended that MRP should be spread over the estimated useful life of either an asset created, or other purpose of the expenditure. There are two useful advantages of this option: -

- Longer life assets e.g. freehold land can be charged over a longer period than would arise under options 1 and 2.
- No MRP charges need to be made until the financial year after that in which an item of capital expenditure is fully incurred and, in the case of a new asset, comes into service use (this is often referred to as being an 'MRP holiday'). This is not available under options 1 and 2.

There are two methods of calculating charges under option 3:

- a. equal instalment method – equal annual instalments; and
- b. annuity method – annual payments gradually increase during the life of the asset.

Option 4: Depreciation Method

Under this option, MRP charges are to be linked to the useful life of each type of asset using the standard accounting rules for depreciation (but with some exceptions) i.e. this is a more complex approach than option 3.

The same conditions apply regarding the date of completion of the new expenditure as apply under option 3.

9.3 Date of implementation

The previous statutory MRP requirements ceased to have effect after the 2006/07 financial year. Transitional arrangements included within the guidance no longer apply for the MRP charge for 2009/10 onwards. Therefore, options 1 and 2 should only be used for Supported Capital Expenditure (SCE).

9.4 Minimum Revenue Provision Policy Statement 2010/11

The Council has implemented the new MRP guidance and will assess their MRP for 2010/11 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

The Council will adopt option 3 as set out above and will charge MRP over the asset life method.

Estimated life periods will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

10. Annual Investment Strategy and Investment Policies

10.1 The Council will have regard to the DCLG's Guidance on Local Government Investments ("the Guidance") issued in March 2004, any revisions to this guidance, the Audit Commission's report on Icelandic investments and the 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are:

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

The London Borough of Barking and Dagenham will aim to achieve optimum returns on its investments after careful consideration of level of security and liquidity. The Council will not lower its counterparty ratings in order to optimise its return on investments. Borrowing of monies purely to reinvest is unlawful, the Council will not engage in such activities.

10.2 Investment instruments identified for use in the financial year are listed in **Appendix C** to this report. Under the requirements of the Investment Guidance issued by the Department of Communities, investments need to be classified into specified and non-specified. The Annual Investment Strategy states which investments the Council may use during the financial year. It is a requirement to report these investments to the Assembly for approval. It is the delegated responsibility of the S151 Officer to determine the exact instrument to use within these classifications. Appendix C also sets out:

- The procedures for determining the use and limits of each asset class of investments (advantages and associated risk), particularly if the investment falls under the category of "non-specified investments"; and
- The maximum periods for which funds may be prudently committed in each asset class.

10.3 For 2010/10, the Council will continue its strategy to invest in products which most importantly minimise risk and obtain favourable returns. The Council will maintain a mixed portfolio of investments in 2010/11. Where the maximum returns can be achieved and on the advice of our advisers, we may seek to invest in structured investment products and money market funds. In addition our external fund

managers may seek to invest in pooled money market funds with permitted weighted average maturity of less than 1 year so can be classified as specified investments. Gilts investments will continue to remain on a segregated basis.

10.4 The monitoring of counterparties will be kept under continuous review. Due to the current economic crisis and issues within the banking sector, all investments made in house will be held in UK institutions. The Council's external fund managers will operate within the credit ratings and parameters set in this strategy, but will have the flexibility to invest in institutions outside of the UK.

10.5 Each year, Council Officers consult with its treasury management advisor to determine appropriate benchmarks for investment returns. External fund managers have been informed of these proposed benchmarks and have set their investment strategies accordingly. They are as follows:

Fund Manager	2010/11 Benchmark	Reason
<ul style="list-style-type: none"> • Investec Asset Management • Scottish Widows (SWIP) 	1.50% (or 3 month LIBID, whichever is higher)	<ul style="list-style-type: none"> • Bank Rate now 0.5% as at January 2010 • Bank Rate Forecast to remain within the range of 0.5% and expected to increase to 1.5% in the later part of 2010. • Consideration given to restrictions in counterparties • Maximising of Council's return on investments at minimal risk • Maximisation of the Council's returns in order to meet budget pressures

The power to change benchmarks as above is delegated to the Chief Financial Officer.

10.7 The Council may permit its external fund managers to use instruments such as gilts, bonds, pooled funds, callable investments and other longer-dated instruments. Limits will have to be established in the use of such instruments to ensure that the Council can have access to its investments. These Treasury Management limits can be set as either a £ amount or percentage.

10.8 Investments defined as capital expenditure
The acquisition of share capital or loan capital in any body corporate is defined as capital expenditure under Section 16(2) of the Local Government Act 2003. Such investments will have to be funded out of capital or revenue resources and will be classified as 'non-specified investments'.

10.9 A loan or grant by this Council to another body for capital expenditure by that body is also deemed by regulation to be capital expenditure by this Council. It is therefore important for this Council to clearly identify if the loan has made for policy reasons (e.g. to the registered social landlord for the construction/improvement of

dwelling) or if it is an investment for treasury management purposes. The latter will be governed by the framework set by the Council for 'specified' and 'non-specified' investments.

10.10 Provisions for Credit-related losses

If any of the Council's investments appeared at risk of loss due to default, (i.e. this a credit-related loss and not one resulting from a fall in price due to movements in interest rates) the Council will make revenue provision of an appropriate amount. Where there is a loss of the principal amount borrowed due to the collapse of the institution, the Council will seek legal advice and consult with its advisers.

10.11 Investment instruments identified for use in the financial year are listed below under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices.

10.12 The Council's external fund managers will comply with the Annual Investment Strategy. The agreements between the Council and the fund managers also stipulate guidelines on duration and other limits in order to contain and control risk.

10.13 Investment Objectives

All investments will be in sterling. The general policy objective for this Council is the prudent investment of its treasury balances. The Council's investment priorities are the security of capital and liquidity of its investments. The Council will aim to achieve the optimum return on its investments commensurate with the proper levels of security and liquidity. We have set challenging targets for 2010/11, and the risk of balancing returns with prudence will need to be managed.

10.14 The DCLG maintains that 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.

11. Security of Capital: the Creditworthiness Policy

11.1 For the Council the duty to protect capital is paramount, improved performance is only achieved by taking effective decisions regarding the timing and duration of the investment rather than making 'higher-risk' investments to generate higher returns.

11.2 Monitoring of credit ratings:

- The Council has had regard for the new CIPFA guidance on credit ratings. This suggests that the lowest rating out of all agencies should be used to define creditworthiness. This is deemed to be unworkable as the Council's in-house team only invests in UK institutions and this would leave too few lenders on the list.
- The Council will use the creditworthiness service provided by Sector Treasury Services. Data is provided on a weekly basis. This service enables the Council to have access to ratings from all three credit rating agencies – Fitch, Moodys and Standards and Poors in addition data which reviews market indicators. This will be reviewed on an ongoing basis. The Council believes that this will provide sufficient control over creditworthiness.

- The Council will continue to keep up to date with market information, market data and information on government support for banks and credit ratings of that government support as an additional means of monitoring its counterparties. Where in doubt, the Council will seek the advice of its treasury adviser.
- 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;
- If counterparty is down graded but still meets the Council's minimum criteria, it would be watched closely and any further downgrading would result in the Council removing it from its lending list. It should however be noted that where the Council enters in to a fixed term deposit, the borrower has no obligation to entertain any request for premature redemption, the Council may ask for the deposit to be broken, however this is not market practice and the institution is under no obligation to comply.
- If a counterparty is upgraded so that it fulfils the Council's criteria, its inclusion will be considered and put to the S151 Officer for approval;
- The Council will establish with its fund managers their credit criteria and the frequency of their monitoring of credit ratings so as to be satisfied as to their stringency and regularity; and
- The Council will continue its approach of investing no more than 20% of its aggregate funds to any particular counterparty or £15m which ever is higher.

11.3 Country Limits and Use of Foreign Banks

To ensure that the Council's investments is not concentrated in too few counterparties or countries, the Council will invest in strong UK and non UK foreign banks which meet its minimum criteria, however the Council's internal team will only invest in UK banks and building societies except on the advise of the Council's treasury management adviser. A suitable spreading approach in itself is likely to be sufficient given the safeguard already given to the creditworthiness service.

The Council's fund managers may invest in foreign banks which in their judgement have sound standing, meet the Council's minimum credit rating criteria and whose sovereign have a AAA long-term credit rating. No more than 30% of the Council's total aggregate funds will be invested in any one country apart from the UK.

11.5 *UK banking system support package*

The Council will continue to use counterparties under the UK banking system support package. However where the Council will lend to these banks it would not only rely on the implicit guarantee given by the government but in addition consider the credit ratings of the individual bank and UK government sovereign rating.

11.6 *Use of other Local Authorities*

Where the investment is a straightforward cash loan the Local Government Act 2003 s13 suggest that the credit risk attached to English and Welsh local authorities is an acceptable one. The Council will limit its lending to local authorities in England and Wales.

11.7 *Use of Multilateral Development Banks*

S15 of the Local Government Act 2003 SI 2004 no. 534 amended provides regulations to clarify that investments in multilateral development banks were not to be treated as being capital expenditure. Should the Council invest in such institutions then only such institutions with AAA credit rating and government backing would be invested in consultation with the Council's treasury management adviser and the S151 Officer.

11.8 Use of Brokers

The Council deals with many of its counterparties directly through its daily dealings, from time to time, the Council will use the services of brokers to act as agents between the Council and its counterparties when lending or borrowing.

12. Use of External Fund Managers

12.1 It is the Council's policy to use external fund managers for part of its investment portfolio. The fund managers will use both specified and non-specified investment categories, and are contractually committed to keep the Council's investment strategy. The level of external balances is under constant review as the level of capital receipts diminishes. The performance of each manager is challenged quarterly by the S151 Officer or delegated officers and the Council's treasury advisers.

12.2 The Council currently uses two fund managers, Scottish Widows (SWIP) and Investec Asset Management. £56m of the Council's funds are currently managed on a discretionary basis by Investec and Scottish Widows. In selecting the institutions to include in their counterparty listing it is the external manager's policy to maintain a list of counterparties and assets based on the Council's set minimum criteria. This list is approved by their specialist credit team who independently research all potential counterparties before inclusion and regularly monitor and update to ensure that any change in credit worthiness and valuation is captured.

In order to comply with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, to ensure that the Council's cash is not pooled with the Pension Fund's cash, the Council will designate the cash managed by one its external managers for the purpose of the pension fund. It is anticipated that the £18m currently managed by SWIP is designated for this purpose and a top up provided to the sum of the difference between the pension fund cash and the cash managed by SWIP.

12.3 Both fund managers provide the Council with a periodic outlook on fund returns. For 2010/11, the worst case is 1.0%, and best case is 2.0%. These scenarios are based on the recent trend of the MPC rate which has continuously remained at 0.5% with no predicted rate change in the next two quarters.

12.4 Investec will be employing a strategy which will enable them buy shorter dated Certificate of deposits because in the current economic climate the upside for capital gains is limited. Investec will continue to use other instruments like, Floating Rate Notes, supranational bonds in addition to gilts in order to increase returns of the portfolio. However, they expect to see higher yield before establishing a position.

In choosing its counterparty, in addition to the Council's minimum credit rating, Investec employs further credit rating criteria which considers the size of the institution and activity in Sterling markets.

12.5 Scottish Widows provide the Council with a forecast of their returns on the Council's investments based on the use of STL and GLF funds as the main part of the Council's portfolio. In the an environment where interest rates have moved to extremely low levels and is expected to remain so for most of 2010/11 financial year, SWIP will be permitted to use UCIT funds as part of the existing portfolio asset allocation. The absolute return bond fund and the credit advantage fund may also be used in the course of the year if advantageous.

12.6 Pension Fund Cash
London Borough of Barking and Dagenham will comply with the requirements of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, which were implemented on 1st Jan 2010, therefore from 1st April 2010 will not pool pension fund cash with its own cash balances for investment purposes. Any investments made by the pension fund directly with this local authority after 1 April 2010 will comply with the requirements of SI 2009 No 393. From 1 April 2010, the Pension Fund Cash will be separated from the remainder of the Council's cash and investment balances in accordance with latest guidance and best practice.

13. Reporting of Treasury management

13.1 Mid way in the financial year and at the end of the financial year, the Council will report on its investment and borrowing activity as part of its Mid Year Treasury Management Report and also its Annual Treasury Management Report and.

14. Consultation

The following were consulted during the preparation of this report

Councillor G Bramley – Cabinet Member for Finance and Human Resources
Tracie Evans – Director of Finance and Commercial Services
John Hooton – Strategic Financial Controller
Miriam Adams – Treasury and Pension Manager
Winston Brown – Legal Partner
External – Sector Treasury Services

15 Background Papers Used in the Perpetration of the Report:

Local Government Act 2003
CIPFA – Revised Prudential Code for Capital Finance in Local Authorities
CIPFA – Revised Treasury Management in the Public Services
Draft capital programme 2010/11 – 2012/13
Monthly Treasury Management Report
Draft Medium Term Financial Strategy 2010/11 to 2012/13

16 Appendices:

Appendix A - The Treasury Management Indicators and Prudential Indicators for 2010/11

Appendix B - Interest Rate Forecasts And Economic Background

Appendix C – Investment Classification

Appendix D - 2010/11 Treasury Management Practices and Scheme Of Delegation

Appendix E - Reporting Arrangements