# REPORT FOR: CABINET

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|---|---|
| **Date:** | 11 February 2010 |
| **Subject:** | Treasury Management Strategy, Prudential Indicators and Minimum Revenue Provision (MRP) Policy and Strategy 2010/11 |
| **Key Decision:** | Yes |
| **Responsible Officer:** | Myfanwy Barrett, Corporate Director Finance |
| **Portfolio Holder:** | David Ashton (Leader and Portfolio Holder for Strategy, Partnership and Finance) |
| **Exempt:** | No |
| **Decision subject to Call-in:** | No |
| **Enclosures:** | Appendix 1 - Prospects for Interest Rates and Economic Background |

## Section 1 – Summary and Recommendations


This report sets out the Council's Treasury Management Strategy and Minimum Revenue Provision (MRP) Policy and Strategy for 2010/11

**Recommendations:**
The Cabinet is requested to recommend the Council to approve:

- The Treasury Management Strategy and Prudential Indicators;
- The Minimum Revenue Provision Policy and Strategy for 2010/11; and
- Note the proposal to allocate the responsibility for the scrutiny of the Treasury Management Strategy, Policy and Activity to Governance, Audit and Risk Management (GARM) Committee as set out in paragraph 7.

**Reason**
To promote effective financial management and comply with the Local Authorities (Capital Finance and Accounting) Regulations 2003 and other relevant guidance.

# Section 2 – Report

### Introduction

1. The Local Government Act 2003 and supporting regulations require the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

2. The Act therefore requires the Council to set out its 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.

3. 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, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from: -
   - increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
   - any increases in running costs from new capital projects

   are affordable within the projected income of the Council for the foreseeable future.

### The Revised CIPFA Treasury Management Code of Practice 2009

4. In the light of the Icelandic situation in 2008, CIPFA has amended the CIPFA Treasury Management in the Public Services Code of Practice (the Code), Cross-Sectoral Guidance Notes and Guidance Notes and the template for the revised Treasury Management Policy Statement.

5. The revised Code has emphasised a number of key areas including the following: -
   a) All councils must formally adopt the revised Code and adopt, as part of their standing orders, financial regulations, or other formal policy documents appropriate to their circumstances, the following four clauses:-
      i) The Council will create and maintain, as the cornerstones for effective treasury management:
         - a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities;
         - suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities; and

      ii) The Council will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.
      iii) The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and the execution and administration of treasury management decisions to the S151

officer, who acts in accordance with the organisation's approved policy statement and TMPs.

iv) The Council nominates GARM to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

b) The strategy report will affirm that the effective management and control of risk are prime objectives of the Council's treasury management activities.
c) The Council's appetite for risk must be clearly identified within the strategy report and will affirm that priority is given to security of capital and liquidity when investing funds and explain how that will be carried out.
d) Responsibility for risk management and control lies within the organisation and cannot be delegated to any outside organisation.
e) Credit ratings should only be used as a starting point when considering risk. Use should also be made of market data and information, the quality financial press, information on government support for banks and the credit ratings of that government support.
f) Councils need a sound diversification policy with high credit quality counterparties and should consider setting country, sector and group limits.
g) Borrowing in advance of need is only to be permissible when there is a clear business case for doing so and only for the current capital programme or to finance future debt maturities.
h) The main annual treasury management reports MUST be approved by full council.
i) There needs to be, as a minimum, a mid year review of treasury management strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved.
j) Each council must delegate the role of scrutiny of treasury management strategy and policies to a specific named body.
k) Treasury management performance and policy setting should be subjected to prior scrutiny.
l) Members should be provided with access to relevant training.
m) Those charged with governance are also personally responsible for ensuring they have the necessary skills and training.
n) Responsibility for these activities must be clearly defined within the organisation.
o) Officers involved in treasury management must be explicitly required to follow treasury management policies and procedures when making investment and borrowing decisions on behalf of the Council (this will form part of the updated TMPs).

**Adoption of the Revised CIPFA Treasury Management Code of Practice 2009**

6. The Council currently meets most of the key areas of the revised code, and some key examples where it demonstrates best practice are listed below:-
   i) The Council delegates responsibility for the implementation and monitoring of its Treasury Management Policy to Cabinet and for the execution and administration of treasury management decisions to the Council's Section 151 Officer;
   ii) The Council uses the creditworthiness service provided by Sector Treasury Services. This service has been progressively enhanced over the last year and now uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the overlays as set out on next page : -
      - credit watches and credit outlooks from credit rating agencies

- ❖ Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings
- ❖ sovereign ratings to select counterparties from only the most creditworthy countries

This modelling approach combines credit ratings, credit watches, credit outlooks and CDS spreads in a weighted scoring system for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments and are therefore referred to as durational bands; and

iii) The Section 151 Officer chairs the Treasury Management Group (TMG) which consists of Deputy Section 151 Officer, Business Partner for Treasury Management and the Treasury and Pensions manager, to monitor the treasury management activity and market conditions.

7. The revised code also requires the Audit or Scrutiny committee to have responsibility for the scrutiny of treasury management policies and practices. It is proposed that from April 2010 GARM is asked to change its terms of reference to include the responsibility for the scrutiny of the Treasury Management Strategy, Policy and Activity. The change in terms of reference will be considered by GARM on 8 April 2010 and then referred to full Council for approval.

**Treasury Management Policy Statement**

8. The Council defines its treasury management activities as: “The management of the authority’s investments and 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”.

9. 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 organisation.

10. Harrow council recognises 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 value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

**Treasury Management Strategy for 2010/11**

11. The suggested strategy for 2010/11 is based upon the treasury officers’ views on interest rates, supplemented with leading market forecasts provided by the Council’s treasury adviser, Sector Treasury Services. The Strategy covers:-
    - Treasury Limits
    - Prudential Indicators;
    - Interest rate outlook and Economic Background
    - Borrowing Strategy.
    - Debt Rescheduling
    - Investment Strategy;
    - MRP Strategy

## Treasury Limits for 2010/11 to 2012/13

12. It is a statutory duty under Section 3 of the Act 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”. In England and Wales the Authorised Limit represents the legislative limit specified in the Act.

13. The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is ‘acceptable’.

14. The term an “Affordable Borrowing Limit”, relates to the financing of capital plans by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

## PRUDENTIAL INDICATORS FOR 2010/11 – 2012/13

15. The following Prudential Indicators are set out below.
    - Table 1 shows the Council’s treasury portfolio position as at 31 December 2009 and the limits for the maturity structure of fixed rate borrowing during 2010/11; and
    - Table 2 includes estimates of capital expenditure; ratio of financing costs to the net revenue stream; Capital Financing Requirement; the incremental impact of capital decisions; the authorised limits and operational boundary for external debt; upper limit for fixed rate interest rate exposure and total sums invested for more than 364 days.

**Table 1**

| **Treasury position as at 31 December 09** | | **Principal** | | **Ave. rate** |
|---|---|---|---|---|
| | | £m | £m | % |
| Fixed rate funding | PWLB | 130.4 | | |
| | Market | 76.8 | 207.2 | 4.6 |
| Variable rate funding | | | 0 | |
| Other long term liabilities | | | 0 | |
| **Total Debt** | | | **207.2** | **4.6** |
| | | | | |
| **Total Investments** | | | **82.2** | **1.63** |

| **Maturity structure of fixed rate borrowing during 2010/11** | **upper limit** | **lower limit** |
|---|---|---|
| under 12 months | 20% | 0% |
| 12 months and within 24 months | 20% | 0% |
| 24 months and within 5 years | 30% | 0% |
| 5 years and within 10 years | 40% | 10% |
| 10 years and above | 95% | 30% |

**Table 2**

| PRUDENTIAL INDICATOR | 2008/09 | 2009/10 | 2010/11 | 2011/12 | 2012/13 |
|---|---|---|---|---|---|
| | actual | forecast outturn | estimate | estimate | estimate |
| | £'000 | £'000 | £'000 | £'000 | £'000 |
| **Capital Expenditure** | | | | | |
| Non - HRA | 83,310 | 95,436 | 38,028 | 19,340 | 17,840 |
| HRA | 15,590 | 12,614 | 7,610 | 6,160 | 6,160 |
| **TOTAL Expenditure** | **98,900** | **108,050** | **45,638** | **25,500** | **24,000** |
| **Funding:-** | | | | | |
| Grants | 44,707 | 61,245 | 11,329 | 4,580 | 4,580 |
| Capital Receipts | 3,355 | 1,134 | 5,250 | 5,250 | 5,250 |
| Revenue Financing | 1,000 | 0 | 500 | 500 | 500 |
| Major Repairs Allowance | 3,557 | 3,778 | 3,942 | 4,056 | 4,113 |
| **Total Funding** | **52,619** | **66,157** | **21,021** | **14,386** | **14,443** |
| | | | | | |
| **Borrowing to Fund the Capital Programme** | **46,281** | **41,893** | **24,617** | **11,114** | **9,557** |
| | | | | | |
| **Ratio of financing costs to net revenue stream** | | | | | |
| Non - HRA | 5.73% | 9.25% | 11.62% | 12.09% | 12.24% |
| HRA | 26.87% | 24.31% | 29.11% | 28.43% | 27.62% |
| **Net borrowing requirement** | | | | | |
| brought forward 1 April | 129,288 | 144,667 | 190,165 | 172,889 | 159,386 |
| carried forward 31 March | 144,667 | 190,165 | 172,889 | 159,386 | 157,829 |
| **in year borrowing requirement** | **-15,379** | **-45,498** | **17,276** | **13,503** | **1,557** |
| **Capital Financing Requirement (CFR) as at 31 March** | | | | | |
| Non – HRA | 196,536 | 220,512 | 230,816 | 228,030 | 223,257 |
| HRA | 47,580 | 56,166 | 59,095 | 60,449 | 61,746 |
| **Total** | **244,116** | **276,678** | **289,911** | **288,479** | **285,003** |
| **Annual change in CFR** | | | | | |
| Non – HRA | 29,911 | 23,976 | 10,304 | -2,786 | -4,773 |
| HRA | 10,673 | 8,586 | 2,928 | 1,354 | 1,297 |
| **Total** | **40,584** | **32,562** | **13,232** | **-1,432** | **-3,476** |
| | | | | | |
| **Incremental impact of capital investment decisions** | **£ p** | **£ p** | **£ p** | **£ p** | **£ p** |
| Increase in council tax (band D) per annum | 49.87 | 46.07 | 25.27 | 13.65 | 8.63 |
| Increase in average housing rent per week | 5.55 | 2.38 | 3.01 | 2.66 | 2.39 |
| **Authorised Limit for external debt** | | | | | |
| Borrowing | 217 | 276 | 301 | 312 | 321 |
| Other long term liabilities | 0 | 0 | 0 | 0 | 0 |
| **Total** | **217** | **276** | **301** | **312** | **321** |
| **Operational Boundary for external debt** | | | | | |
| Borrowing | 217 | 254 | 279 | 290 | 299 |
| Other long term liabilities | 0 | 0 | 0 | 0 | 0 |
| **Total** | **217** | **254** | **279** | **290** | **299** |
| **Upper limit for fixed interest rate exposure** | | | | | |
| Net principal re fixed rate borrowing / investments | 217 | 254 | 279 | 290 | 299 |
| **Upper limit for variable rate exposure** | | | | | |
| Net principal re variable rate borrowing/Investments | 85 | 100 | 115 | 125 | 135 |
| Upper limit for total principal sums invested for over 364 days | 11 | 50 | 25 | 50 | 50 |

16. The calculations of the upper limit for fixed and variable rate exposures are prescribed by the CIPFA Code. In order to calculate these limits over the three year periods as required it is necessary to undertake projections of possible borrowing and investment levels.

**Interest Rate Outlook and Economic Background**

17. The base rate has remained unchanged at 0.5% since March 2009. Based on the Sector view it is expected to start rising gradually with the first increase in Q3 2010 and then to be back up to 3.5% during Q1 2012. Appendix 1 shows a range of opinions on future interest rates and economic background, including the Sector view.

18. The Council will therefore avoid locking into longer term deals while investment rates are down at historically low levels unless exceptionally attractive rates are available which make longer term deals worthwhile.

**Borrowing Strategy**

19. Sector and other views on future PWLB rates are included at Appendix 1. 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 may offer some opportunity for new borrowing to spread the debt maturities away from a concentration in long dated debt.

20. As the Council's investments are in excess of the borrowing requirement over the next year, it would be prudent to utilise internal funds to finance the capital programme. The main advantages of the internal borrowing are:-
    - It contributes towards mitigating the loss on investment income in the short term, as long term borrowing rates are expected to be higher than rates on the investment income, and
    - The running down of investments also has the benefit of reducing the exposure to interest rate and counter party risks.

21. Against this background, an increase in caution will be adopted with regard to the 2010-11 treasury operations. The Corporate Director of Finance will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to Cabinet at the first available opportunity.

22. 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 will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

**DEBT RESCHEDULING**

23. 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. However, significant interest savings

may still be achievable through using LOBOs (Lenders Option Borrowers Option) loans and other market loans if these become available in rescheduling exercises.

24. 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 flattening of the maturity profile as in recent years there has been a skew towards longer dated PWLB.

25. 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.
    The reasons for any rescheduling to take place will include:
    - the generation of cash savings and / or discounted cash flow savings,
    - helping to fulfil the objectives of the borrowing strategy; and
    - altering the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

26. There has been much discussion as to whether the size of spread between long term PWLB repayment and new borrowing rates should be revised (downwards) in order to help local authorities currently dissuaded from using investment cash balances to repay long term borrowing and thereby reduce counterparty and interest rate risk exposure. The Debt Management Office(DMO) / Public Works Loans Board(PWLB) has issued a consultation document with suggested options to revise the methodology used to calculate the early repayment rate. The consultation period ended in January 2010 and the Council will monitor developments in this area and may amend its strategy if significant changes are introduced.

27. All rescheduling will be reported to Cabinet at the earliest meeting following the exercise.

**ANNUAL INVESTMENT STRATEGY**

**Investment Policy**

28. The Council approves a Treasury Management Strategy on an annual basis and has adopted the ‘CIPFA code of Practice for Treasury Management in the Public Services’.

29. The Council will have regard to the CLG’s Guidance on Local Government Investments (“the Guidance”) issued in March 2004, any revisions to that 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;
    (b) the liquidity of its investments.

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

31. 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.

32. 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.

33. Specified investments are considered low risk and relate to funds invested for up to one year. Non-Specified investments sometimes offer the prospect of higher returns but carry a higher risk and have a maturity beyond one year.

**Specified Investments**

34. All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum rating criteria where applicable. The instruments and credit criteria to be used are set out in the table below.

| Instrument | Minimum Credit Criteria | Use |
|---|---|---|
| Debt Management Agency Deposit Facility | Government backed | In-house |
| Term deposits – other LAs | Local Authority issue | In-house |
| Term deposits – banks and building societies | AA- Long Term<br>F1+Short-term<br>2 Support<br>B Individual<br>AAA Sovereign | In-house |
| UK Nationalised banks | F1+ Short-term<br>1 Support | In-house |
| Money Market Funds | AAA | In-house |

**Non-Specified Investments**

**Maturities in excess of 1 year**

| | Minimum Credit Criteria | Use | *Max % of total investments | Max. maturity period |
|---|---|---|---|---|
| Term deposits – banks and building societies | AA- Long Term<br>F1+ Short-term<br>2 Support<br>B Individual<br>AAA Sovereign | In-house | 50% | 5 yrs |
| Callable Deposits | F1+ Short term<br>A Long Term | In-house | 20% | 5 yrs |

35. All credit ratings will be monitored in house with the help of Sector who alert the Council to changes in Fitch ratings through its creditworthiness service. If a downgrade results in the counterparty no longer meeting the Council's minimum criteria, its further use as an investment will be withdrawn immediately.

**Investment Strategy**

36. The Council's funds are mainly cash flow derived and include the General Fund, Pension Fund, West London Waste Authority and Housing Revenue Account balances.

37. Officers will continue to invest funds on a risk spread basis with the security of capital being the primary consideration. Funds will be "locked in" for longer periods only if it is prudent to do so. Due to low interest rates and to reduce the exposure to counter party risk, it would be prudent to take advantage of internal borrowing to fund the capital programme for 2010-11. This will mean lower cash balances which means that a prudent estimated gross investment return would be around £1.250m for the year. The net gain after allocating out the investment return across all funds would be around £0.690m to the Council's budget.

**MINIMUM REVENUE PROVISION**

**What is a Minimum Revenue Provision?**

38. 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 and so such expenditure is spread over several years so as to try to match the years over which such assets benefit the local community through their useful life. The manner of spreading these costs is through an annual Minimum Revenue Provision (MRP), which was previously determined under Regulation, and will in future be determined under Guidance.

**Statutory duty**

39. Statutory Instrument 2008 no. 414 s4 lays down that:

    "A local authority shall determine for the current financial year an amount of minimum revenue provision that it considers to be prudent."

    The above is a substitution for the previous requirement to comply with regulation 28 in S.I. 2003 no. 3146 (as amended).

    There is no requirement to charge MRP where the Capital Financing Requirement is nil or negative at the end of the preceding financial year.

    The share of Housing Revenue Account CFR is not subject to an MRP charge

**Government Guidance**

40. Along with the above duty, the Government issued new guidance which came into force on 31 March 2008 which requires that a Statement on the Council's policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which the provision will relate.

41. The Council is legally obliged to "have regard" to the guidance, which is intended to enable a more flexible approach to assessing the amount of annual provision than was required under the previous statutory requirements. The guidance offers four main options under which MRP could be made, with an overriding recommendation that the

Council should make prudent provision to redeem its debt liability over a period,which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. The requirement to 'have regard' to the guidance therefore means that: -

- Although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent;
- It is the responsibility of each authority to decide upon the most appropriate method of making a prudent provision, after having had regard to the guidance.

42. Essentially, the Guidance may only be applied to new capital expenditure relative to the period to which the annual MRP relates. This means that debt which remains outstanding in respect of earlier capital expenditure will continue to be subject to MRP at the rate of 4% per annum. New debt up to the limit of the Council's annual supported capital expenditure amount may also continue to be charged at 4%, but apart from this, expenditure to be financed from borrowing is recommended to be subject to MRP on the estimated useful life basis. This may either be assessed as equal annual instalments, or lower early year charges on an annuity basis, or in accordance with depreciation accounting methods.

**MRP Policy Statement 2010/11**

43. The Council implemented the new Minimum Revenue Provision (MRP) guidance in (2007/08), and will assess its 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.

44. The major proportion of the MRP for 2010/11 will relate to the more historic debt liability that will continue to be charged at the rate of 4%, in accordance with the guidance. Certain expenditure reflected within the debt liability at 31st March 2010 will under delegated powers be subject to MRP, which will be charged over a period which is reasonably commensurate with the estimated useful life applicable to the nature of expenditure, using the equal annual instalment method (or annuity method if preferred). For example, capital expenditure on a new building, or on the refurbishment or enhancement of a building, will be related to the estimated life of that building.

45. When adopting this aspect of the recommendations contained within the guidance, the Council will, where applicable, treat any new capital expenditures/schemes which are both commenced and finalised within the financial year as having been financed from any associated grants, S.106 monies, or similarly earmarked funds. However, the amount of resources available and used for financing in accounting terms within each financial year will be fully allocated within that year, which means that in cases where expenditure is incurred on only part of a scheme which is not completed by the year end, any grant or similar financing resources will be allocated to other new expenditures under delegated powers.

46. 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

- In the case of new capital expenditures which serve to add to the value of an existing capital asset, these will be estimated to have the remaining useful life as the asset whose value is enhanced.
- To the extent that expenditures are not on the creation of an asset, and are of a type that are subject to estimated life periods that are referred to in the Guidance, these periods will generally be adopted by the Council. However, in the case of long term debtors (e.g. West London Waste Authority) arising from loans or other types of capital expenditure made by the Council which will be repaid under separate arrangements, there will be no Minimum Revenue Provision made. The Council is satisfied that a prudent provision will be achieved after exclusion of these capital expenditures from the MRP requirements.
- In view of the variety of different types of capital expenditure incurred by the Council, which is not in all cases 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.

47. The determination as to which schemes shall be deemed to be financed from available resources, and those which will remain as an outstanding debt liability to be financed by borrowing or other means, will be assessed under delegated powers.

## Financial Implications

48. Financial matters are integral to the report.

## Environmental Impact

49. There are no direct environmental impacts.

## Performance Issues

50. Treasury Management is scored as part of one of the Key Line of Enquiry on Financial Standing. The Council meets the requirements of the CIPFA Code of Practice for Treasury Management and therefore is able to demonstrate best practices for the Treasury Management function, contributing to the overall score on the Use of Resources.

## Risk Management Implications

51. There is a risk that the Council could lose a deposit due to the failure of a Counter Party and any movement in interest rates will have an impact on the investment income and borrowing costs.

    Risk included on Directorate risk register? Yes
    Separate risk register in place? No

## Corporate Priorities

52. This report deals with the Treasury Management Strategy which is a key to delivering the Council’s corporate priorities.

## Section 3 - Statutory Officer Clearance

| | | |
|---|---|---|
| Name: Myfanwy Barrett<br><br>Date: 27 January 2010 | √ | Chief Financial Officer |
| Name: Hugh Peart<br><br>Date: 25 January 2010 | | on behalf of the Monitoring Officer |

## Section 4 – Performance Officer Clearance

| | | |
|---|---|---|
| Name: Alex Dewsnap<br><br>Date: 25 January 2010 | √ | Divisional Director |

## Section 5 – Environmental Impact Officer Clearance

| | | |
|---|---|---|
| Name: John Edwards<br><br>Date: 22 January 2010 | √ | Divisional Director |

## Section 6 - Contact Details and Background Papers

**Contact:** Jennifer Hydari (Divisional Director, Finance & Procurement) Tel: 020-8424-1393 / Email: jennifer.hydari@harrow.gov.uk

**Background Papers:**

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| **Call-In Waived by the Chairman of Overview and Scrutiny Committee** | **NOT APPLICABLE*** |

**Appendix 1**

## PROSPECTS FOR INTEREST RATES

The Council has appointed Sector Treasury Services as treasury adviser to the Council and part of their service is to assist the Council to formulate a view on interest rates.

### Bank Base Rate Forecast

| | Q/E1 2010 | Q/E2 2010 | Q/E3 2010 | Q/E4 2010 | Q/E1 2011 | Q/E2 2011 | Q/E3 2011 | Q/E4 2011 | Q/E1 2012 | Q/E2 2012 | Q/E3 2012 | Q/E4 2012 | Q/E1 2013 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | % | % | % | % | % | % | % | % | % | % | % | % | % |
| **Sector** | 0.50 | 0.50 | 0.75 | 1.00 | 1.50 | 2.25 | 2.75 | 3.25 | 3.50 | 3.75 | 4.25 | 4.25 | 4.50 |
| **Capital Economics** | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | **Forecast not available** | | | | |
| **UBS** | 0.50 | 0.50 | 0.75 | 1.00 | 1.50 | 2.00 | 2.50 | 3.00 | **Forecast not available** | | | | |

### PWLB New Borrowing Rate Forecast

**Sector forecast**

| | Q/E1 2010 | Q/E2 2010 | Q/E3 2010 | Q/E4 2010 | Q/E1 2011 | Q/E2 2011 | Q/E3 2011 | Q/E4 2011 | Q/E1 2012 | Q/E2 2012 | Q/E3 2012 | Q/E4 2012 | Q/E1 2013 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | % | % | % | % | % | % | % | % | % | % | % | % | % |
| **5yr** | 3.05 | 2.25 | 2.15 | 2.15 | 2.15 | 2.45 | 2.80 | 3.15 | 3.65 | 3.95 | 4.20 | 4.45 | 4.60 |
| **10yr** | 4.00 | 4.05 | 4.15 | 4.30 | 4.45 | 4.60 | 4.80 | 4.90 | 5.00 | 5.10 | 5.10 | 5.15 | 5.15 |
| **25yr** | 4.55 | 4.65 | 4.70 | 4.80 | 4.90 | 5.00 | 5.05 | 5.10 | 5.20 | 5.30 | 5.30 | 5.35 | 5.35 |
| **50yr** | 4.60 | 4.70 | 4.75 | 4.90 | 5.00 | 5.10 | 5.15 | 5.20 | 5.30 | 5.40 | 5.40 | 5.45 | 5.45 |

**Capital Economics forecast**

| | Q/E1 2010 | Q/E2 2010 | Q/E3 2010 | Q/E4 2010 | Q/E1 2011 | Q/E2 2011 | Q/E3 2011 | Q/E4 2011 |
|---|---|---|---|---|---|---|---|---|
| | % | % | % | % | % | % | % | % |
| **5yr** | 2.65 | 2.15 | 2.15 | 2.15 | 2.15 | 2.15 | 2.15 | 2.15 |
| **10yr** | 3.15 | 2.65 | 2.65 | 2.65 | 2.65 | 2.65 | 2.65 | 2.65 |
| **25yr** | 3.95 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 |
| **50yr** | 4.15 | 4.05 | 4.05 | 4.05 | 4.05 | 4.05 | 4.05 | 4.05 |

**UBS forecasts**

| | Q/E1 2010 | Q/E2 2010 | Q/E3 2010 | Q/E4 2010 |
|---|---|---|---|---|
| | % | % | % | % |
| **5yr** | **Forecast not available** | | | |
| **10yr** | 3.90 | 4.05 | 4.40 | 4.75 |
| **25yr** | 4.45 | 4.65 | 5.00 | 5.15 |
| **50yr** | 4.55 | 4.75 | 5.10 | 5.25 |

## ECONOMIC BACKGROUND

### Introduction

- The credit crunch storm of August 2007 eventually fed through to the near collapse of the world banking system in September 2008. This then pushed most of the major economies of the world into a very sharp recession in 2009 accompanied by a dearth of lending from banks anxious to rebuild their weakened balance sheets. Many governments were forced to recapitalise and rescue their major banks and central banks

precipitately cut their central bank rates to 0.10 – 1.00% in order to counter the recession.

- The long awaited start of growth eventually came in quarter 3 2009 in the US and the EU. However, there was disappointment that the UK failed to emerge from recession in quarter 3.
- Inflation has plunged in most major economies and is currently not seen as being a problem for at least the next two years due to the large output gaps and high unemployment putting a lid on wage growth. In many countries there have been widespread pay freezes in 2009 and these are likely to be persistent for some time.
- Deflation could become a threat in some economies if they were to go into a significant double dip recession.
- Asian countries, especially China, are buoying world demand through their own stimulus measures.
- There still needs to be a radical world rebalancing of excess savings rates by cash rich Asian and oil based economies and excess consumption rates in Western economies if the world financial system is not to avoid a potential rerun of this major financial crisis in years to come.
- Most major economies have resorted to a huge expansion of fiscal stimulus packages in order to encourage a fast exit from recession. This, together with expenditure on direct support provided to ailing banks, has led to a drastic expansion in government debt levels which will take many years to eliminate and to restore the previous health of national finances.

**UK**

- GDP growth will almost get back to the long term average of about 2.5% in 2011 but is likely to peak in the first half of the year as inventory rebuilding and stimulus measures fade and fiscal contraction kicks in later in the year.
- The economy will rebalance with strong growth in exports and import substitution helped by strong recovery in the EU and the rest of the world.
- Sterling has depreciated by 25% since the peak in 2007 and is likely to stay weak.
- Consumer spending – only a mediocre recovery is expected due to a steady increase in the savings ratio from +5.6% in 2009 to about 8% in 2011 as consumers pay down debt or build cash balances. Consumer incomes will be held down by wage freezes and increases in taxation.
- House price recovery is expected to persist helped by a low Bank Rate for a prolonged period; the peak to trough fall in house prices is now expected to be no more than 20%. House prices to rise by about 6% in 2010, and 3% in 2011; mortgage approvals will rise back to the level of 75 - 80,000 per month needed to ensure a continuation of a trend of rising house prices.
- CPI inflation to peak at 2.5% in early 2010 after the rise in VAT in January but then to fall to a trough near 1.5% in early 2011 and to stay below 2% for the rest of 2011.
- The current MPC attitude is one of hang on as long as possible before increasing Bank Rate. The aim of this would be to try to ensure that growth gets going at a decent rate and that Bank Rate gets back to 4 – 5% before the next recession and that all assets purchased through QE have been sold off by then. The first Bank Rate increase is expected in Q3 2009.

- The fiscal deficit is 6.4% of GDP, about £90bn, which is expected to fall to £11bn p.a. over eight years at currently planned rates. This is similar to the peak deficit of 7% in the 1990s which was remedied to a surplus of 1.6% in the space of 6 years helped by strong, steady economic growth of 3% p.a. supported by loose monetary policy that compensated for the fiscal squeeze.
- Gilt yields, especially longer term ones, are currently artificially low due to the Bank of England's Quantitative Easing operations. £200bn of gilts, commercial bonds and paper are being purchased under this scheme which has inflated prices and depressed yields. Once this campaign ends, yields will inevitably rise but will also rise due to the huge level of issuance of new gilts to finance the fiscal deficit. Long gilt yields are therefore forecast to reach 6% during 2011.
- Gilt yields could rise higher if there was a hung Parliament in 2010 or if the fiscal situation deteriorates further.
- The major risk to this scenario would be a lack of supply of bank credit. However, it is felt that the Bank of England is on alert to ensure that this does not happen and would continue various measures to assist the expansion of credit.

**Two growth scenarios**

- The current big issue is 'how quickly will the major world economies recover?' There is a sharp division of opinion on this question as set out below.

Strong recovery

- This is a normal cyclical recovery which will be strong in the major world economies. The US still has potential to add further fiscal stimulus in 2010 to ensure that strong recovery continues after the current round of stimulus measures end. Growth in the EU is likely to be strong in 2010 and not require such help.

Weak recovery

- The current economic cycle is not a normal business cycle but a balance sheet driven cycle. Over borrowed banks, corporates and consumers are focused on shrinking their levels of borrowing to more viable and affordable levels and this balance sheet adjustment will take several years to be effected. Repayment of debt will therefore act as a major head wind to the required increase in demand in the economy. Consequently there will only be weak economic recovery over the next few years after the initial sharp inventory rebuilding rebound fades. GDP growth is forecast to reach only +1.5% in 2011.
- Fiscal contraction will further dampen economic recovery driven by a strong political agenda to accelerate cuts in expenditure and increases in taxation after the general election in 2010.