Appendix 2

Treasury Management Strategy 2012/13

Background

In accordance with the Council's Treasury Management Practices (TMPs) and The Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management in the Public Services: Code of Practice, the Council is required to approve the Treasury Management Strategy and Annual Investment Strategy for 2012/13. The Treasury Management Strategy is reflected in the Personal Assurance Statement given by the Director of Resources concerning the 2012/13 budget calculations.

Treasury Management is undertaken by a team of professionally qualified staff within the Resources Directorate.

In addition the Council employs Treasury Management advisors, Sector, who provide information and advice on interest rate movements which is used to inform borrowing and investment decisions. The advisors are engaged on a fixed term basis after a tendering procedure.

Relevant information is also obtained from other financial commentators, the press and seminars arranged by other organisations, for example CIPFA and the Local Government Association.

Information received from these different sources is compared in order to ensure all views are considered and there are no significant differences or omissions from information given by the Council's advisors.

All Treasury Management employees take part in the Council's Staff Review and Development scheme where specific individual training needs are highlighted. Training in Treasury Management activities and networking opportunities provided by both professional and commercial organisations are taken up where appropriate.

During 2011/12 to date the County Council has invested its surplus cash with the UK Debt Management Office and with other local authorities. In December 2011 £20million was borrowed from the Public Works Loans Board to support capital expenditure.

Economic Commentary

During the year uncertainty within financial markets has continued to be present particularly in relation to the Euro area sovereign debt crisis. The situation in Europe is likely to depress growth in the UK's biggest export market and together with the plan to reduce the annual fiscal deficit any growth in the economy is likely to be weak in the next two years and there is a risk of a return to recession.

The bank rate has remained at the historically low level of 0.5% throughout the year. Most forecasters suggest that the bank rate will stay at its current level for the time being and start to increase towards the middle of next financial year 2012/13. However there are risks to these forecasts. If economic recovery is slower than expected, then any increase may be delayed. Equally concerns over increases in inflation may cause the rates to increase more quickly.

In October 2010, as part of the Comprehensive Spending Review announcement, the Chancellor announced that PWLB borrowing rates would be set at 1% above the gilt yield. In practice this resulted in an immediate increase of about 0.9% in borrowing rates in all maturity periods while rates applicable to early repayment of debt remained the same. The difference between these two sets of rates has resulted in the opportunities to reschedule debt being considerably restricted.

Treasury Management Strategy

The Prudential Code for Capital Finance requires the Council to set a number of Prudential Indicators (see Appendix 10 to the Cabinet Report). The Treasury Management Strategy has been developed in accordance with these indicators.

Borrowing Strategy

The outlook for borrowing rates is currently difficult to predict. Fixed interest borrowing rates are based on UK gilt yields and since national debt is forecast to continue to increase until 2015/16, so in turn are gilt yields and therefore borrowing rates. However gilt yields are currently at historically low levels due to continued investor concerns over the Euro area sovereign debt crisis.

The County Council's Treasury Management advisors have produced forecasts which suggest that rates over all periods of borrowing will start to increase steadily in 2012/13. Rates on loans of 5 years are forecast to be around 2.5% while rates on longer term loans are expected to be around 4.5% by the end of 2012/13.

The County Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure.

The strategy will be to borrow in order to replenish a proportion of the reserves and cash balances used to support capital expenditure since October 2008. This will mitigate any interest rate risk because borrowing will be taken before borrowing rates increase significantly. The timing of the borrowing will depend on cash flow requirements, on interest rate movements and the forecast for those future movements. A mixture of shorter and longer-term loans will be taken in order to fit with the County Council's debt maturity profile.

In addition to this, the gross capital borrowing requirement for the 2012/13 financial year is estimated to be £29.4million. After the use of the minimum revenue provision to repay debt of £15.7million, the net capital borrowing requirement is estimated to be £13.7million.

Interest rates will be monitored but as forecasts stand it is likely that borrowing will be undertaken towards the middle of the financial year.

The management of the County Council’s debt portfolio will be exercised in the most efficient manner taking into account when existing debt matures. The opportunity will be taken to reschedule any outstanding debt if rates are favourable, and make savings in the revenue budget. The cost of external interest of maintaining the County Council's debt is estimated to be £16.2 million in 2012/13.

Annual Investments Strategy

The Council's Investment Strategy has been drawn up having regard to both the Communities and Local Government's Guidance on Local Authorities Investments and the CIPFA Treasury Management in Public Services Code of Practice and CIPFA Cross-Sectoral Guidance Notes. This strategy will be revised and presented to Council if changes occur outside those envisaged within this Strategy.

The policy objective for the Council is the prudent investment of its cash balances. The investment priorities are firstly the security of capital (protecting sums from capital loss) and secondly the liquidity of investments (ensuring cash is available when required). Only when these two priorities are met will the third, of achieving the optimum return on investments, be taken into account.

The Council will not borrow money purely to invest. The Council will only borrow up to 12 months in advance of cash being required to fund its capital expenditure.

The investments, which the Council are able to use for the prudent management of cash balances are categorised as ‘Specified Investments’ and ‘Non-Specified Investments’.

A Specified Investment offers high security and high liquidity, must be in sterling and have a maturity date of less than a year. Any Specified Investment must be with the United Kingdom Government, a local authority in England or Wales or a similar body in Scotland or Northern Ireland, a parish or community council or with a body of high credit quality. The Council defines a body of high credit quality as counterparties who achieve ratings with all three rating agencies as described in the table below.

Agency:	**Long-Term:**	**Short Term:**
Fitch	AA	F1+
Moodys	Aa2	P-1
Standard and Poors	AA	A-1+

Non Specified Investments have a range of vehicles not covered by the definition of Specified Investments and generally carry more risk. Only investments where there is no contractual risk to the capital invested and where the rate of return justifies their use will be entered into. The only category of Non Specified investment identified for use for the coming financial year is a routine term investment with a counter party as described above for Specified Investments, for a period of more than one year. This type of investment will be considered when rates are favourable and cash balances allow. The County Council's prudential indicators allow no more than £5 million to be invested in this category.

The credit ratings of Fitch, Moodys and Standard and Poors are monitored at least weekly, ratings watches and downgrades are acted upon immediately. Any other information that is deemed relevant to the creditworthiness of any Counterparty will be acted upon.

The Council will aim to have not less than 50% of its investments returnable within 30 days with at least 20% within 7 days.

West Mercia Supplies

With regard to the joint ownership of West Mercia Supplies, the County 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 Investments as they are not sterling denominated.