

APPENDIX A: TREASURY MANAGEMENT STRATEGY STATEMENT, MINIMUM REVENUE PROVISION STRATEGY and ANNUAL INVESTMENT STRATEGY 2009/10

1. INTRODUCTION

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

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.

The suggested strategy for 2009/10 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with market forecasts provided by the Council's treasury advisor, and other market commentators. The strategy covers:

- the Minimum Revenue Provision strategy ,and MRP Policy Statement 2009/10;
- treasury limits in force which will limit the treasury risk and activities of the Council;
- Prudential Indicators;
- the current treasury position;
- the borrowing requirement;
- prospects for interest rates;
- the borrowing strategy;
- debt rescheduling;
- the investment strategy- proposed 5 tier investment strategy;
- Summary of Recommendations;
- any extraordinary treasury issues (such as the implications of the failure of Icelandic banks);
- Schedule 1- Interest Rate Forecasts;

It is a statutory requirement under Section 33 of the Local Government Finance Act 1992 for the Council to produce a balanced budget. In addition, 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 such that increases in charges to revenue from: -

1. increases in interest charges arising from increased borrowing to finance additional capital expenditure, and
2. any increases in running costs relating to new capital projects

are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

2. MINIMUM REVENUE PROVISION (MRP)

1. What is a Minimum Revenue Provision?

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, so such expenditure is spread over several years in order to match it to the years over which such assets benefit the local community throughout their useful life. The mechanism for spreading these costs is by means of an annual Minimum Revenue Provision, which was previously determined under Regulation, and will in future be determined under Guidance.

2. New statutory duty

Statutory Instrument 2008 no. 414 Section 4 directs 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 if the Capital Financing Requirement (CFR) 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

3. New Government Guidance

Along with the above duty, the Government issued new guidance in February 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.

The Council are 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 approximates to that over which the capital expenditure is estimated to provide benefits. The requirement to ‘have regard’ to the guidance therefore means that: -

1. 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.
2. It is the responsibility of each authority to decide upon the most appropriate method of making a prudent provision, after taking into account the guidance.

Option 1: Regulatory Method

Under the previous MRP regulations, MRP was set at a uniform rate of 4 per cent of the adjusted CFR (that is adjusted for ‘Adjustment A’) on a reducing balance method

(which in effect meant that MRP charges would stretch into infinity). This historic 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 Supported Capital Expenditure (SCE) annual allocation.

Option 2: Capital Financing Requirement Method

This is a variation on option 1 which is based upon a charge of 4 per cent 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 reflected in its balance sheet.

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 to 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
- 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.

4. Date of implementation

The previous statutory MRP requirements cease to have effect after the 2006/07 financial year. However, the same basis of 4 per cent charge may continue to be used without limit until the 2009/10 financial year, relative to expenditure incurred up to 31 March 2009.

In general, it is recommended that Authorities should adopt the recommendations contained within the guidance. However, in certain cases the guidance may recommend a useful life period/MRP for expenditure which it may not be considered appropriate to adopt. It is suggested that full details of MRP options/principles adopted should be set out and approved as part of the annual MRP Policy Statement.

LONDON BOROUGH OF WALTHAM FOREST MINIMUM REVENUE PROVISION POLICY STATEMENT 2009/10

The Council will implement the new Minimum Revenue Provision (MRP) guidance in 2008/09, and assess their MRP for 2008/09 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 major proportion of the MRP for 2007/08 will relate to the historic debt liability that will continue to be charged at the rate of 4per cent, in accordance with option 1 of the guidance. The Capital Financing Requirement calculation is balance sheet based, adjusted as prescribed under previously existing regulations (Adjustment A). Certain expenditure, which had previously been financed by unsupported borrowing, and reflected within the debt liability at 31 March 2008, will under delegated powers be subject to MRP under option 3, which will be charged over a period which approximates to the estimated useful life applicable to the category of expenditure using the equal annual instalment method. 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. Going forward, it is proposed that MRP calculations which reflect ongoing capital expenditure elements met from supported borrowing will be based on option 1, and calculations reflecting capital expenditure elements met from unsupported borrowing will be based on option 3.

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, best estimates will generally be adopted by the Council. 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.

3. TREASURY LIMITS FOR 2009/10 TO 2011/12

It is a statutory duty under Section 3 of the Local Government Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the 'Affordable Borrowing Limit'. In England and Wales the Authorised Limit represents the legislative limit specified in section 3 of the Local Government Act 2003.

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'.

Whilst termed an 'Affordable Borrowing Limit', the capital plans to be considered for inclusion incorporate financing 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.

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

The following Prudential Indicators (in tables 1 and 2 below) are relevant for the purposes of setting an integrated Treasury Management Strategy.

The CIPFA Code of Practice on Treasury Management was adopted in February 1994 by Full Council.

PRUDENTIAL INDICATOR	2007/08	2008/09	2009/10	2010/11	2011/12
(1). EXTRACT FROM BUDGET AND RENT SETTING REPORT	£'000	£'000	£'000	£'000	£'000
	actual	probable outturn	estimate	estimate	estimate
Capital Expenditure					
Non – HRA	37,712	42,318	31,830	31,600	25,250
HRA (applies only to housing authorities)	64,888	51,459	60,083	93,195	109,146
TOTAL	102,600	93,777	91,913	124,795	134,396
Ratio of financing costs to net revenue stream					
Non – HRA	2.17%	2.19%	2.32%	2.41%	2.59%
HRA (applies only to housing authorities)	13.02%	14.11%	13.52%	13.58%	13.23%
Capital Financing Requirement as at 31 March					
Non – HRA	124,884	126,683	134,302	133,141	135,000
HRA (applies only to housing authorities)	210,120	239,150	262,180	285,210	308,000
TOTAL	335,004	365,833	396,482	418,351	443,000
Incremental impact of capital investment decisions	£ p	£ p	£ p	£ p	£ p
Increase in council tax (band D) per annum *	0	0	0	0	0
Increase in average housing rent per week (housing authorities only)	0	0	0	0	0

PRUDENTIAL INDICATOR	2007/08	2008/09	2009/10	2010/11	2011/12
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£'000	£'000	£'000	£'000	£'000
	actual	probable outturn	estimate	estimate	estimate
Authorised Limit for external debt -					
Borrowing	345,000	375,900	406,500	428,400	453,000
other long term liabilities	5,000	10,000	10,000	10,000	10,000
TOTAL	350,000	385,900	416,500	438,400	463,000
Operational Boundary for external debt -					
Borrowing	335,000	365,900	396,500	418,400	443,000
other long term liabilities	3,000	5,000	5,000	5,000	5,000
TOTAL	338,000	370,900	401,500	423,400	448,000
Upper limit for fixed interest rate exposure					
Net principal re fixed rate borrowing / investments	100 %	100 %	100 %	100 %	100 %
Upper limit for variable rate exposure					
Net principal re variable rate borrowing / investments	20%	20%	20%	20%	20%
Upper limit for total principal sums invested for over 364 days (per cent of total invested) (per maturity date)	20%	20%	20%	20%	20%

Maturity structure of fixed rate borrowing during 2009/10	upper limit	lower limit
under 12 months	5%	0%
12 months and within 24 months	5%	0%
24 months and within 5 years	5%	0%
5 years and within 10 years	5%	0%
10 years and above	100%	80%

5. CURRENT PORTFOLIO POSITION

The Council's Treasury portfolio position at 31 December 2008 was as follows:

Outstanding Balances	2008/09 December £'000	Int-Rate %
PWLB Loans	242,700	4.92%
Market Loans	51,365	5.28%
Total Borrowing	294,065	4.98%
Total Deposits / Investments	67,892	3.12%
Net Borrowing	226,173	5.54%

6. BORROWING REQUIREMENT

The underlying borrowing requirement for 2009/10 is estimated at **£32 million**.

7. PROSPECTS FOR INTEREST RATES

General Economic Background

- The sub prime crisis of early 2008 was supplanted by the banking crisis of autumn 2008. The world banking system came near to collapse and governments around the world were forced to recapitalise and rescue their major banks. The resulting dearth of lending from banks anxious to preserve capital led to sharp reductions in economic growth forecasts as recession was priced into markets. This in turn led to sharp falls in oil and other commodity prices with the result that inflation, which in the UK was running at over 5 per cent, became yesterday's story as recession fears increasingly drove interest rate sentiment and policy. A co-ordinated global interest rate cut of 50 basis points took place on 8 October 2008. Forecasts in the UK indicated further sharp cuts in interest rates as the prospects of recession intensified.
- **International Economic Review**
- Early in 2008 the US economy was being badly affected by the housing market slump. Interest rates were at 2 per cent and inflation was being dragged higher by the inexorable rise in commodity prices. The European Central Bank (ECB) was more concerned about rising inflation than the state of the economy.
- The second quarter of 2008/9 was torn between inflation worries on the one hand, with oil rising towards \$150 per barrel, and the deteriorating economic outlook on the other.
- In the second and third quarters of the year the financial crisis erupted and escalated as the world became aware of the extent of the sub-prime problem and the impact it was having on institutions that had invested in infected financial instruments.
- In September Fannie Mae/ Freddie Mac (the mortgage banks) and AIG, the insurance giant, had to be bailed out by the US Federal Government.
- Then in mid September, Lehman Brothers, the investment bank, was allowed to fail. This triggered a domino effect with other banks and financial institutions having to be rescued or supported by governments around the world.
- After the collapse into receivership of the Icelandic banks in early October, other countries then started to feel the strain and a number had to approach the IMF for support.
- Eventually even the Asian 'Tiger' economies were affected, including India and China, and it became clear that the crisis had become global, with no country insulated from the fallout.
- The financial crisis had therefore precipitated an economic crisis and there was a co-ordinated global interest rate cut with the Federal Reserve (Fed), European Central Bank (ECB) and Monetary Policy Committee (MPC) all cutting rates by 50bp on 8 October. The Fed subsequently cut rates again by 50bp to 1 per cent on 29 October in an attempt to stave off the looming recession. Inflation had become yesterday's problem.

- On 4 November the USA elected Barack Obama as President with little immediate financial impact.
- The ECB reduced rates again on 6 November by 50bp and by its biggest ever cut of 75bp on 4 December..

- **UK Economic Review**

- The rate of growth in UK Gross Domestic Product (GDP) was already slowing in 2008 relative to 2007 before the full impact of the credit crunch was felt. Earlier in 2008 GDP was 2.3 per cent whereas in the autumn the figure fell back to (0.3) per cent and was then expected to remain negative going into 2009.
- Wage inflation remained relatively subdued as the Government kept a firm lid on public sector pay. Private sector wage growth was kept in check by the slowdown in the economy.
- Growth slowed across the economy and unemployment rose throughout the year with forecasts of 2 million unemployed by the end of the financial year and continued increases during 2010.
- Notwithstanding the pressures on household finances, consumer spending still continued at a reasonable level although the trend was slowing as the year progressed.
- Bank lending came to a virtual standstill in the autumn as the credit crunch tightened its grip and various banks internationally had to be rescued, or supported, by their governments.
- The Government and Bank of England supplied massive amounts of liquidity to the banking system in an attempt to re-ignite longer term interbank lending.
- The Government took action in September to either supply finance to recapitalise some of the major clearing banks, or to require other banks to strengthen their capital ratios by their own capital raising efforts. This action was undertaken in order that banks would be seen to have sufficient reserves to last through the oncoming recession and the inevitable increase in bad debts etc.
- The housing market also came to a virtual standstill as lenders demanded larger deposits and higher fees. House sales and prices both dropped sharply.
- Government finances deteriorated as income from taxation dropped, the economy slowed and the cost of the bailout of the banks was added to the deficit.
- U.K. equity prices declined sharply in Quarters 3 and 4 as the impending recession was priced into the markets. Share prices hit five year lows and market volatility was considerable.
- The story of 2008 has been the credit crunch, the banking crisis and the change in economic outlook from slow growth to outright recession. After the initial concerns about the impact of the credit crunch in the earlier part of 2008 it appeared as though the storm had been weathered. The Monetary Policy Committee (MPC) had been very concerned about Consumer Prices Index (CPI) inflation, which had been rising sharply on the back of higher commodity and food prices. Bank Rate had previously reached a peak of 5.75 per cent in July 2007, after which cuts of 0.25 per cent occurred in December 2007 and February and April 2008 before the major cuts in the autumn. The economic data had been indicating a slowing economy for some time but this was not sufficient to force the MPC into a further cut.

- It was the severity of the banking crisis, pre-empted by the collapse of Lehman Brothers in New York that eventually drove the MPC to cut interest rates by 50bp on October 8, in concert with the Federal Reserve, the ECB and other central banks. It had by now become apparent that the economic downturn would be far more severe than previously anticipated and interest rates were subsequently slashed by 150bps on 6 November and by a further 100bps on 4 December.
- The London Inter Bank Offer Rate (LIBOR) – the rate at which banks will lend to one another, spread over Bank Rate has also been a feature and a concern, during 2008/9. Because of the credit fears and the reluctance of lenders to place cash for long periods, 3 month LIBOR has been substantially higher than Base Rate. This has meant that the MPC power over monetary policy has been eroded by the widening of this spread between LIBOR and Base Rate. This has in turn limited the ability of the MPC to bring relief to hard pressed borrowers through lower interest rates. However, increased Government influence over the semi nationalised clearing banks has had a considerable impact in enforcing pro rata reductions to the 150 bps Bank Rate cut in November.
- The Government has abandoned its 'golden rule'. The pre Budget Report on 14 November revealed the Government's plans for a huge increase in Government borrowing over the coming years as a result of falling tax revenues, tax cuts and increases in Government expenditure, designed in the short term to help stimulate economic growth in order to counter the recession.

Sector Interest Rate Forecasts

The Council employs Sector Treasury Services as treasury adviser and part of their service is to assist the Council in formulating a view on interest rates. Schedule 1, attached to this report, draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table provides Sector's current interest rate forecast.

Sector interest rate forecast – December 2008

	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009	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
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.75%	2.50%	3.25%	3.75%	4.00%
5yr PWLB rate	2.50%	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 PWLB rate	3.10%	2.75%	2.55%	2.55%	2.55%	2.85%	3.25%	3.65%	4.15%	4.40%	4.70%	4.75%	4.85%
25yr PWLB rate	4.00%	3.95%	3.95%	3.95%	4.00%	4.15%	4.35%	4.45%	4.60%	4.85%	4.95%	5.00%	5.05%
50yr PWLB rate	3.85%	3.80%	3.80%	3.80%	3.85%	3.90%	4.00%	4.25%	4.40%	4.70%	4.80%	4.95%	5.00%

Sector's current interest rate view is that Bank Rate: -

- will fall from current levels because of the intensifying global recession
- Starting 2009 at 2.00 per cent, Bank Rate is forecast to fall to 0.5 per cent in Quarter 1 2009
- It is then expected to remain at this level until starting to rise gently up from Quarter 2 2010 until it reaches 4.0 per cent in Quarter 1 2012.
- There is downside risk to these forecasts if the recession proves to be deeper and more prolonged than currently expected.
- It should be noted that Capital Economics takes a significantly more pessimistic view on the severity of the recession and its impact on interest rates. They predict that the base rate will have fallen to 0 per cent by the Quarter 2 2009 and will remain at this level until the 3rd Quarter 2010

8. BORROWING STRATEGY

The Sector Public Works Loan Board (PWLB) rate forecast is as follows. (These forecasts are based around an expectation that there will normally be variations of +/- 25bp during each quarter around these average forecasts in normal economic and political circumstances. However, greater variations can occur should there be any unexpected shocks to financial and/or political systems.) The forecasts relate to the PWLB new borrowing rate: -

- The 50 year PWLB rate is expected to remain around current levels of about 3.80 to 3.90 per cent until Quarter 2 2010 when it is forecast to rise to 4.00 per cent. The rate then edges up gradually to reach 5.00 per cent at the end of the forecast period.
- The 25 year PWLB rate is expected to drop to 3.95 per cent in Quarter 1 2009 and remain around this level until starting to rise in Quarter 1 2010. It will then eventually rise to 5.05 per cent at the end of the forecast period.
- The 10 year PWLB rate is expected to drop to 2.55 per cent in Quarter 3 2009, but then to start rising again in Quarter 2 2010, and eventually reach 4.85 per cent at the end of the forecast period.
- The 5 year PWLB rate is expected to fall to a floor of 2.15 per cent during Quarter 3 2009. The rate then starts rising in Quarter 2 2010, eventually reaching 4.60 per cent by the end of the forecast period.

The forecasts, therefore, indicate that there is a range of options available for borrowing strategy for 2009/10. Variable rate borrowing is expected to be cheaper than long term borrowing and will therefore be attractive throughout the financial year, as compared to simply taking long term fixed rate borrowing. Under 10 year PWLB rates are expected to be substantially lower than longer term PWLB rates so this will open up a range of choices for new borrowing for authorities that want to spread their debt maturities away from a concentration in long dated debt. **Rates are expected to be slightly lower at the middle to end of the year than earlier on so it may be advantageous to borrow later in the year.**

The Council's Borrowing Policy 2009/10 will take into account the following anticipated market developments

- The under-10 year PWLB rates will provide significantly cheaper options than longer term borrowing. Under 5 year rates are also expected to be significantly lower than 5 to 10 year rates. Rates are expected to be slightly lower at the middle to end of the year so it may be advantageous to borrow later in the year.
- Long term interest rates are anticipated to fall to historically low levels during 2009/10. There is expected to be little difference between 25 year and 50 year rates. However, despite the minimally more expensive new borrowing rates expected in the 25 to 30 year period later in the year, these could be seen as being much more attractive than 50 year borrowing as the spread between the PWLB new borrowing and early repayment rates is considerably less. This will maximise the potential for debt rescheduling at a later stage by minimising the spread between these two rates.
- This strategy would also mean that after some years of focusing on borrowing at or near the 50 year period, the Council would be able to undertake borrowing in a markedly different period and so achieve a better spread in its debt maturity profile.
- When long term PWLB rates fall back to the central forecast rate of about 3.95 per cent, borrowing should be made at any time in the financial year. A suitable trigger point for considering new fixed rate long term borrowing, therefore, would be 3.95 per cent. The central forecast rate will be reviewed in the light of movements in the slope of the yield curve, spreads between PWLB new borrowing and early payment rates, and any further changes that the PWLB may introduce to their lending policy and operations.
- Consideration will also be given to borrowing fixed rate market loans at 25 to 50 basis points below the PWLB target rate if they become available again.

External v. internal borrowing

- The next financial year is expected to be characterised by a historically low Bank Rate. This opens up an opportunity for Authorities to fundamentally review their strategy of undertaking external borrowing.
- **In view of the fact that the Council's surplus cash balances are likely to exceed anticipated borrowing requirements in 2009/10, consideration needs to be given to the potential merits of internal borrowing, which can be achieved by running down current surplus cash balances .**
- **Since long term borrowing rates are currently higher than rates on short term investments, and seem likely to remain so throughout 2009/10, consideration could also be given to avoiding all new external borrowing in the next financial year in order to maximise savings in the short term.**
- The running down of investments also has benefits of reducing exposure to interest rate and credit risk.
- Following the freezing of some Local Authority investments by Icelandic banks now in receivership, many Local Authorities are currently concerned about the safety of investments and the ability of Authorities to rely on credit ratings as a basis for ensuring that investments can be undertaken safely, especially over extended periods of time.

Against this background, caution will be exercised in respect of the Council's 2009/10 treasury operations. The Director of Finance's Treasury Management officers will monitor the money markets and adopt a pragmatic approach to changing circumstances, reporting any significant developments to the Cabinet /Council at the next available opportunity.

Sensitivity of forecasts – The main sensitivities of the interest rate forecasts are likely to be the two scenarios below. The Council officers, in conjunction with treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

- Any indications of a significant risk of a sharp rise in long and short term rates, perhaps arising from a greater than expected increase in world economic activity or further increases in inflation, would prompt a re-appraisal of the portfolio position, possibly resulting in increased fixed rate borrowing at relatively low rates of interest.
- Any indications of a significant risk of sharp falls in long and short term rates, due to e.g. growth rates weakening, will result in long term borrowing being postponed, and a possible re-emphasis on short term borrowing will be considered.

It is anticipated that the Council will have an underlying borrowing requirement of £32 million in 2009/10. Estimated cash surpluses available for short term investment are expected to average £50 million. There is a consensus amongst market analysts that short term rates will continue to fall during 2009/10 (some commentators anticipating a 0 per cent base rate by the second quarter 2009). Accordingly the recommended borrowing strategy is to postpone any borrowing until the 2nd Quarter of the year at the earliest (running down short term cash surpluses to cover any day to day cash flow deficits). When it is felt that long term PWLB rates have reached their floor, possibly in the 2nd or 3rd quarter of the year, the situation should be reviewed, and consideration given to locking into historically low PWLB rates over periods of 25 to 50 years.

9. DEBT RESCHEDULING

The introduction of differential 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 to 50 basis points for the longest period loans narrowing down to 25 to 30 basis points for the shortest loans), has meant that PWLB to PWLB debt restructuring is now much less attractive than previously. The Council undertook a major debt rescheduling exercise in February 2007 which resulted in significant savings on annual interest rate charges as well as a substantial improvement in the Council's debt maturity profile. **Therefore, no further debt rescheduling is currently recommended in 2009/10.**

10. ANNUAL INVESTMENT STRATEGY

10.1 Investment Policy

The Council will have regard to the ODPM's Guidance on Local Government Investments ('the Guidance') issued in March 2004 and CIPFA's 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.

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

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

10.2 Investment Strategy

Following the recent turbulence in the Financial Markets, a fundamental review of the Council's investment Strategy has taken place. Full details are provided in Appendix B.

In view of the continuing difficulties in securing an appropriate return on cash deposits with suitably rated counterparties, Members are requested to approve the implementation of the 5 tier investment strategy outlined in Appendix B with immediate effect (that is from week commencing 2 March 2009).

End of year investment report

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

11. TREASURY STRATEGY – SUMMARY OF RECOMMENDATIONS

The Council is recommended to adopt the following:

- Approve the basis of the MRP calculation as outlined in Section 2 of this Report, including the decision to apply option 1 for existing and new capital expenditure financed from supported borrowing; and option 3 for capital expenditure financed from unsupported borrowing
- Approve the revised Prudential Indicators detailed in Section 4.
- Agree (subject to ongoing in year review) to the postponement of any borrowing until the 2nd Quarter of the year 2009/10, at which time the situation to be assessed, and consideration given to locking into anticipated historically low PWLB rates over periods of 25 to 50 years.
- Agree (subject to ongoing in year review) that no further debt rescheduling

should be planned for 2009/10.

- Approve the implementation of the 5 tier investment strategy outlined in Appendix B with immediate effect (that is from week commencing 2 March 2009).

11. OTHER ISSUES

ICELANDIC BANK INVESTMENTS:- Background Information

The London Borough of Waltham Forest has no cash deposits frozen in failed Icelandic banks.

Local Authority Deposits in Failed Icelandic Banks - Current Position

The Icelandic Government has stated its intention to honour all of its commitments as a result of its banks being placed into receivership. The U.K Government is working with the Icelandic Government to help bring this about. At the current time it is not possible to say with certainty whether the entirety of Local Authority investments will be recovered or when reimbursements will be made. The Local Government Association is co-ordinating the efforts of all UK Authorities affected by the Icelandic banks' failures

The Government informed Local Authorities in November 2008 that it intends to introduce a regulation to require Local Authorities to delay recognising any eventual losses on these investments until the financial year 2010-11.

INTEREST RATE FORECASTS

The data below shows a variety of forecasts published by a number of institutions. The first three are individual forecasts including those of UBS and Capital Economics (an independent forecasting consultancy). The final one represents summarised figures drawn from the population of all major City banks and academic institutions.

The forecast within this strategy statement has taken into account these diverse sources of information.

1. INDIVIDUAL FORECASTS

Sector interest rate forecast – December 2008

	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009	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
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.75%	2.50%	3.25%	3.75%	4.00%
5yr PWLB rate	2.50%	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 PWLB rate	3.10%	2.75%	2.55%	2.55%	2.55%	2.85%	3.25%	3.65%	4.15%	4.40%	4.70%	4.75%	4.85%
25yr PWLB rate	4.00%	3.95%	3.95%	3.95%	4.00%	4.15%	4.35%	4.45%	4.60%	4.85%	4.95%	5.00%	5.05%
50yr PWLB rate	3.85%	3.80%	3.80%	3.80%	3.85%	3.90%	4.00%	4.25%	4.40%	4.70%	4.80%	4.95%	5.00%

Capital Economics interest rate forecast –December 2008

	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009	Q/E1 2010	Q/E2 2010	Q/E3 2010	Q/E4 2010
Bank Rate	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
5yr PWLB rate	1.65%	1.45%	1.45%	1.45%	1.45%	1.45%	1.45%	1.45%
10yr PWLB rate	2.65%	2.15%	2.15%	2.15%	2.15%	2.15%	2.15%	2.15%
25yr PWLB rate	4.15%	4.00%	3.80%	3.65%	3.65%	3.65%	3.65%	3.65%
50yr PWLB rate	4.05%	3.95%	3.85%	3.75%	3.75%	3.75%	3.75%	3.75%

UBS interest rate forecast (for quarter ends) – December 2008

	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009
Bank rate	0.50%	0.50%	0.50%	0.75%
10yr PWLB rate	3.75%	4.15%	4.35%	4.65%
25yr PWLB rate	4.25%	4.55%	4.85%	5.05%
50yr PWLB rate	4.30%	4.65%	5.00%	5.25%

2. SURVEY OF ECONOMIC FORECASTS

HM Treasury – December 2008 summary of forecasts of 23 City and 12 academic analysts for Quarter 4 2008 and 2009. Forecasts for 2010 to 2012 are based on 21 forecasts in the last quarterly forecast – November 2008.

BANK RATE FORECASTS		quarter ended		annual average Bank Rate		
	actual	Q4 2008	Q4 2009	ave. 2010	ave. 2011	ave. 2012
Median	2.00%	2.00%	1.00%	3.11%	3.97%	4.49%
Highest	2.00%	4.50%	4.00%	4.70%	5.00%	5.25%
Lowest	2.00%	2.00%	0.50%	1.00%	2.25%	3.00%