Annex 1

Treasury Management Strategy Statement and Annual Investment Strategy for 2011/12

1 Introduction

1.1 Background

1.1.1 Treasury management is defined as:

"The management of the local 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. "

1.2 Statutory requirements

1.2.1 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.

1.2.2 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 subsequent to the Act and included at Section 7 of this report); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

1.2.3 The Department of Communities and Local Government has issued revised investment guidance which came into effect from 1 April 2010. There were no major changes required over and above the changes already required by the revised CIPFA Treasury Management Code of Practice 2009.

1.3 CIPFA requirements

1.3.1 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) was adopted by this Council on 18 February 2010.

1.3.2 The primary requirements of the Code are as follows:

1 Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

2 Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

3 Receipt by the full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

4 Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

5 Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Audit Committee.

1.3.3 The scheme of delegation and role of the Section 151 officer that give effect to these requirements are set out at **[Appendix 1]** and **[Appendix 2]** respectively.

1.4 Treasury Management Strategy for 2011/12

1.4.1 The suggested strategy for 2011/12 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser, Sector.

1.4.2 The strategy covers:

- treasury limits in force which will limit the treasury risk and activities of the Council
- the current treasury position
- the borrowing requirement
- Prudential and Treasury Indicators
- prospects for interest rates
- creditworthiness policy
- the investment strategy
- policy on use of external service providers

1.5 Balanced Budget Requirement

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

2 Treasury Limits for 2011/12 to 2013/14

2.1 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.

2.2 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'.

2.3 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; details of the Authorised Limit can be found in **[Appendix 3]** of this report.

3 Current Portfolio Position

3.1 The Council is debt free and as such the overall treasury position at 31/12/10 comprised only investments, which totalled £41.9m and were generating an average return of 1.35%

4 Borrowing Requirement

4.1 Other than for cash flow purposes and then within the limits set out at **[Appendix 3]** borrowing will not be necessary.

5 Prudential and Treasury Indicators for 2011/12 – 2013/14

5.1 Prudential and Treasury Indicators as set out in **[Appendix 3]** are relevant for the purposes of setting an integrated treasury management strategy.

5.2 The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The original 2001 Code was adopted on 30 September 2003 and the revised 2009 Code was adopted by the full Council on 18 February 2010.

6 Prospects for Interest Rates

6.1 The Council has appointed Sector as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates. **[Appendix 4]** draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Sector central view.

Sector Bank Rate forecast for financial year ends (March)

2010/ 2011	0.50%
2011/ 2012	1.00%
2012/ 2013	2.25%
2013/ 2014	3.25%

6.2 There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected. A detailed view of the current economic background is contained within **[Appendix 5]** to this report.

7 Annual Investment Strategy

7.1 Investment Policy

7.1.1 The Council will have regard to the CLG's Guidance on Local Government Investments ("the Guidance") 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:

- the security of capital and
- the liquidity of its investments.

7.1.2 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investments.

7.1.3 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.

7.1.4 Investment instruments identified for use in the financial year are listed in **[Appendix 6]** under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set out at paragraph 7.3.2.

7.2 Creditworthiness policy

7.2.1 This Council uses the creditworthiness service provided by Sector. 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, Moody and Standard and Poor forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:

- credit watches and credit outlooks from credit rating agencies
- CDS spreads to give early warning of likely changes in credit ratings; and
- sovereign ratings to select counterparties from only the most creditworthy countries.

7.2.2 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads 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. The Council is satisfied that this service now gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.

7.2.3 The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Sector's weekly credit list of worldwide potential counterparties. Subject to an appropriate sovereign and counterparty rating the Council will therefore use counterparties within the following durational bands*:*

Yellow	5 years
Purple	2 years
Blue	1 year (nationalised or part nationalised UK Banks)
Orange	1 year
Red	6 months
Green	3 months

7.2.3 This Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties as Moody tend to be more aggressive in giving low ratings than the other two agencies. This would therefore be unworkable and leave the Council with few banks on its approved lending list. The Sector creditworthiness service does though, use ratings from all three agencies, but by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

7.2.4 All credit ratings will be reviewed weekly and monitored on a daily basis. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list.

7.2.5 Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on government support for banks and the credit ratings of that government support.

7.3 Country, Group and Counterparty Limits

7.3.1 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AAA as determined by at least two of the three rating agencies (Fitch, Moody or Standard and Poor). The list of countries that qualify using this credit criteria as at the date of this report are shown in

[Appendix 7]. This list will be added to, or deducted from; by officers should ratings change in accordance with this policy.

7.3.2 Avoidance of a concentration of investments in too few counterparties or countries is a key to effective diversification and in this regard the limits set out below are thought to achieve a prudent balance between risk and practicality in respect of both core and cash flow funds:

Country, Group and Counterparty	Maximum Proportion of Core and Cash Flow Funds
UK Sovereign	100%
Each non-UK **AAA** Sovereign	25%
Group limit	25%
Each counterparty rated Fitch **F1+, AA-, C, 1** or better	25%
Each nationalised or part nationalised UK bank excluding Ulster Bank (part of RBS)	25%
Each multilateral / supranational bank and as a group	25%
Each bond / gilt / enhanced cash / government liquidity fund rated **AAA**	25%
Each money market fund rated Moody **AAAmr1+**, Fitch **AAAmmf**, Standard & Poor **AAAm**	25%
Non-specified investments over 1 year duration	60%

7.3.3 Cash flow balances vary depending on the timing of receipts and payments during the month and from month to month. For cash flow investments the limits identified in paragraph 7.3.2 will be based on an estimate of the expected average daily cash flow balances at the start of the financial year.

7.4 Investment Strategy

In-house funds

7.4.1 The Council's in-house managed funds currently comprise a mix of core and cash flow funds.

Core investment

7.4.2 The core investments managed internally will be held until maturity unless credit worthiness concerns prompt a request for early repayment. Upon maturity these funds are to be transferred to the external fund manager in order to further reduce counterparty risk, through access to the highest quality names. At 31 December 2010 one internally managed core investment of £2.5m with the Nationwide Building Society was held. This investment, generating interest at 6.25% per annum, is due to mature on 27 May 2011.

Cash flow investments

7.4.3 The average cash flow balance expected to be managed internally during the coming year will be in the region of £6m. That balance excludes surpluses available for longer than 3 months, which under the Investment Strategy for 2010/11 are placed with the external fund manager. For 2011/12 this is to remain the default action unless the Treasury Management Team determines in concert that a better rate of return can be achieved without undue added risk from managing those funds internally.

7.4.4 Investments in respect of cash flow will accordingly be made with reference to the core balance, cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

7.4.5 The Bank Rate has been unchanged at 0.50% since March 2009. The Bank Rate is forecast to commence rising in quarter 3 of 2011 and then to rise steadily from thereon. Bank Rate forecasts for financial year ends (March) are as follows:

- 2010/ 2011 0.50%
- 2011/ 2012 1.00%
- 2012/ 2013 2.25%
- 2013/ 2014 3.25%

There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected.

7.4.6 The Council will avoid locking into longer term deals while investment rates are down at historically low levels unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile and within the risk parameters set by this Council.

7.4.7 An investment return of 0.7% is currently considered achievable on cash flow generated balances. The Council will seek to utilise its business reserve accounts, notice accounts, money market funds and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

External fund managers

7.4.8 During 2011/12 some £18m of the Council's funds will be externally managed on a discretionary basis by Investec Asset Management Ltd who are obliged to comply with the Annual Investment Strategy including the parameters established at paragraphs 7.3.1 and 7.3.2 and the schedule of specified and non-specified investments detailed at **[Appendix 6]**.

7.4.9 Investec's view on interest rates and opportunities for gilts/bonds is as follows:

"The global economy appears in better shape than it did in spring as fears of a double-dip recession fade. The surprise has come from a much stronger upturn in world trade, with business surveys in western markets at new highs, and in some cases making multi decade highs. However, this didn't stop the US from initiating a further $600bn of quantitative easing in early November. The lack of any significant improvement in the level of unemployment and benign inflation were the principal reasons for the Federal Reserve's action. Interestingly, the bond market's reaction has been counter intuitive with a sharp rise in yields, as market participants sense a policy error in the making as the economic data continues to improve and commodity prices continue to soar, raising inflationary concerns.

In the UK there is an increasing perception the MPC will be forced to raise interest rates to contain the persistent inflationary pressures evident in the economy, especially when you combine the upbeat business community. So far the MPC have resisted, implying there is ample spare capacity in the economy that will persist and bear down on inflation in the medium term. Clearly the UK has many challenges to overcome, firstly, employment has not picked up materially and there must be a risk that private sector demand is not sufficiently strong enough to offset the fiscal consolidation which has yet to fully impact.

Secondly, wages are not keeping up with the rise in the cost of living, leaving less disposable income for discretionary spending. Thirdly, the continued financial distress in some of the peripheral euro-area countries could depress activity. Finally, raising interest rates too early could undermine an already fragile recovery.

It's easy to see why interest rates should rise from emergency levels of 0.5%, but equally why they shouldn't. This makes the timing of the next move all the more difficult to predict with certainty. This is likely to mean a cautious approach to the new Financial Year until we have greater conviction for the future path of interest rates. As Certificates of Deposit mature we are likely to reinvest across a range of maturities from 3 to 9 months to cover both eventualities and as the outlook becomes clearer adapt strategy accordingly. Longer dated government bond yields still don't represent good value despite rising over 0.7% from their lowest levels in October".

7.4.10 For 2011/12 the fund manager predicts returns of between 1.0% and 2.0% with a central case forecast of investment return of 1.5%. Based on Sector's expected Bank Rate forecast for 2011/12 the Council's budgeted return on externally managed core fund investments is broadly in line with Investec's central case prediction at 1.3%.

7.5 End of year investment report

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

7.6 Policy on the use of external service providers

7.6.1 The Council uses Sector as its external treasury management advisers.

7.6.2 The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

7.6.3 It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

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Appendices

1. Treasury management scheme of delegation
2. Treasury management role of the section 151 officer
3. Prudential and Treasury indicators
4. Interest rate forecasts
5. Economic background
6. Specified and Non-specified Investments
7. Approved countries for investments

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Appendix 1 Treasury management scheme of delegation

(i) Full council

- budget approval
- approval of treasury management policy.
- approval of the annual Treasury Management Strategy Statement and Annual Investment Strategy.
- approval of amendments to the Council's adopted clauses, Treasury Management Policy Statement and the annual Treasury Management Strategy Statement and Annual Investment Strategy.

(ii) Cabinet

- budget consideration
- approval of Treasury Management Practices
- approval of the division of responsibilities
- approval of the selection of external service providers and agreeing terms of appointment.
- approval of the treasury management outturn report as part of the closure of accounts process.
- acting on recommendations in connection with monitoring reports.

(iii) Audit Committee

- reviewing the annual Treasury Management Strategy Statement and Annual Investment Strategy and making recommendations to Cabinet and Council
- receive reports on treasury activity at regular intervals during the year and make recommendations to Cabinet.
- reviewing treasury management policy, practices and procedures and making recommendations to Cabinet and Council.

(iv) Finance and Property Advisory Board

- receiving budgetary control reports at regular intervals that include treasury management performance.

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Appendix 2 Treasury management role of the section 151 officer

The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers.

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Appendix 3 Prudential and Treasury Indicators

The prudential indicators cannot be set until the capital programme is finally determined and will as a consequence be reported as part of the Setting the Budget for 2011/12 report that is to be submitted to Cabinet on 1 February 2011.

The treasury management indicators are as set out in the table below:

TREASURY MANAGEMENT INDICATORS	2009/10	2010/11	2011/12	2012/13	2013/14
	Actual	Revised Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt :					
borrowing	£305	£5,000	£5,000	£5,000	£5,000
other long term liabilities	£Nil	£Nil	£Nil	£Nil	£Nil
TOTAL	£305	£5,000	£5,000	£5,000	£5,000
Operational Boundary for external debt:-					
borrowing	£305	£2,000	£2,000	£2,000	£2,000
other long term liabilities	£Nil	£Nil	£Nil	£Nil	£Nil
TOTAL	£305	£2,000	£2,000	£2,000	£2,000
Actual external debt	£Nil	£Nil	£Nil	£Nil	£Nil
Upper limit for fixed interest rate exposure > 1 year at year end	£2,500	10%	It is anticipated that net exposure will range between 0% to 60%		
Upper limit for variable rate exposure < 1 year at year end	£22,700	90%	It is anticipated that net exposure will range between 40% to 100%		
Upper limit for total principal sums invested for over 364 days at year end	£2,500	£2,500	60% of core funds		

Maturity structure of fixed rate borrowing during 2011/12	upper limit	lower limit
under 12 months	100 %	0 %
Over 12 months	0 %	0 %

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Appendix 4 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 been drawn from these diverse sources and officers' own views.

1. Individual Forecasts

Sector

Interest rate forecast – 05.01.11

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14
Bank rate	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%	2.25%	2.75%	3.00%	3.25%	3.25%
5yr PWLB rate	3.30%	3.30%	3.40%	3.50%	3.60%	3.80%	3.90%	4.10%	4.30%	4.60%	4.80%	4.90%	5.00%
10yr PWLB rate	4.40%	4.40%	4.40%	4.50%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.30%	5.40%	5.40%
25yr PWLB rate	5.20%	5.20%	5.20%	5.30%	5.30%	5.40%	5.40%	5.40%	5.50%	5.50%	5.60%	5.70%	5.70%
50yr PWLB rate	5.20%	5.20%	5.20%	5.30%	5.30%	5.40%	5.40%	5.40%	5.50%	5.50%	5.60%	5.70%	5.70%

Capital Economics

Interest rate forecast – 8.11.10

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
5yr PWLB rate	2.75%	2.75%	2.75%	2.75%	2.75%	2.75%	2.75%
10yr PWLB rate	3.75%	3.75%	3.75%	3.75%	3.75%	3.75%	3.75%
25yr PWLB rate	4.80%	4.80%	4.80%	4.80%	4.80%	4.80%	4.80%
50yr PWLB rate	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%

UBS

Interest rate forecast (for quarter ends) – 20.10.10

	Mar-11	Jun-11	Sep-11	Dec-11
Bank rate	0.50%	0.50%	0.75%	1.00%
10yr PWLB rate	4.10%	4.30%	4.50%	4.60%
25yr PWLB rate	5.10%	5.10%	5.20%	5.30%
50yr PWLB rate	5.20%	5.20%	5.30%	5.40%

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2. Survey of Economic Forecasts

HM Treasury October 2010

The current Q4 2010 and 2011 forecasts are based on the October 2010 report. Forecasts for 2010 – 2014 are based on 32 forecasts in the last quarterly forecast – in August 2010.

BANK RATE FORECASTS	Bank Rate	Quarter end		Annual ave. Bank Rate				
	actual	Q4 2010	Q4 2011	ave. 2010	ave. 2011	ave. 2012	ave. 2013	ave. 2014
Median	0.50%	0.50%	0.90%	0.50%	1.00%	1.90%	2.80%	3.40%
Highest	0.50%	0.80%	3.20%	0.60%	2.10%	3.10%	4.10%	5.30%
Lowest	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	1.20%

Appendix 5 Economic Background

1 Global economy

The sovereign debt crisis peaked in May 2010 prompted, in the first place, by major concerns over the size of the Greek government's total debt and annual deficit. However, any default or write down of Greek debt would have substantial impact on other countries, in particular, Portugal, Spain and Ireland. This crisis culminated in the EU and IMF putting together a €750bn support package in mid May. A second crisis, this time over Ireland, is currently in progress as at November 2011.

The unexpectedly high rate of growth in quarters 2 and 3 of 2010 in the UK and the Eurozone in Q2 were driven by strong growth in the construction sector catching up from inclement weather earlier in the year and by other short term factors not expected to be enduring; general expectations are for anaemic (but not negative) growth in 2011 in the western world.

2 UK economy

Following the general election in May 2010, the coalition government has put in place an austerity plan to carry out correction of the public sector deficit over the next five years. The inevitable result of fiscal contraction will be major job losses during this period, in particular in public sector services. This will have a knock on effect on consumer and business confidence and appears to have also hit the housing market as house prices started on a negative trend during the summer and autumn of 2010. Mortgage approvals are also at very weak levels and declining, all of which indicates that the housing market is likely to be very weak next year.

Economic Growth – GDP growth is likely to have peaked in the current period of recovery at 1.2% in quarter 2 of 2010. The first estimate of +0.8% for quarter 3 was also unexpectedly high. However, the outlook is for anaemic growth in 2011/12 although the Bank of England and the Office for Budget Responsibility are forecasting near trend growth (2.5%) i.e. above what most forecasters are currently expecting.

Unemployment – the trend of falling unemployment (on the benefit claimant count) has now been replaced since July 2010 with small increases which are likely to be the start of a new trend for some years ahead of rising unemployment.

Inflation and Bank Rate – CPI has remained high during 2010. It peaked at 3.7% in April and has gradually declined to 3.1% in September (RPI 4.6%). Although inflation has remained stubbornly above the MPC's 2% target, the MPC is confident that inflation will fall back under the target over the next two years after another rise back up to about 3.5% by the end of 2010.

The Bank of England finished its programme of quantitative easing (QE) with a total of £200bn in November 2009. However, major expectation that there could be a second round of quantitative easing in late 2010 or early 2011, to help support economic growth, have evaporated after the surprises of the Q3 GDP figure of +0.8% and the November Inflation Report revising the forecast for short term inflation sharply upwards.

Sector's view is that there is unlikely to be any increase in Bank Rate until the end of 2011.

AAA rating – prior to the general election, credit rating agencies had been issuing repeated warnings that unless there was a major fiscal contraction, then the AAA sovereign rating was at significant risk of being downgraded. Sterling was also under major pressure during the first half of the year. However, after the Chancellor's budget on 22 June, Sterling strengthened against the US dollar and confidence has returned that the UK will retain its AAA rating. In addition, international investors now view UK government gilts as being a safe haven from EU government debt. The consequent increase in demand for gilts helped to add downward pressure on gilt yields and PWLB rates.

3 Sector's forward view

It is currently difficult to have confidence as to exactly how strong the UK economic recovery is likely to be, and there are a range of views in the market. Sector has adopted a moderate view. There are huge uncertainties in all forecasts due to the major difficulties of forecasting the following areas:

- the speed of economic recovery in our major trading partners - the US and EU
- the danger of currency war and resort to protectionism and tariff barriers if China does not address the issue of its huge trade surplus due to its undervalued currency
- the degree to which government austerity programmes will dampen economic growth and undermine consumer confidence
- changes in the consumer savings ratio
- the speed of rebalancing of the UK economy towards exporting and substituting imports
- the potential for more quantitative easing, and the timing of this in both the UK and US, and its subsequent reversal
- the speed of recovery of banks' profitability and balance sheet imbalances and the consequent implications for the availability of credit to borrowers
- the potential for a major EU sovereign debt crisis which could have a significant impact on financial markets and the global and UK economy

The overall balance of risks is weighted to the downside and there is some risk of a double dip recession and deleveraging, creating a downward spiral of falling demand, falling jobs and falling prices, although this is currently viewed as being a small risk.

Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries.

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Appendix 6 Specified and Non-specified Investments

All specified and non-specified Investments will be:

subject to the sovereign, group and counterparty exposure limits identified in the Annual Investment Strategy.

subject to the duration limit recommended by Sector (or as assessed by the external fund manager) at the time each investment is placed

subject to a maximum of 60% of core funds, in aggregate, being held in non-specified investments at any one time.

Specified Investments (sterling denominated with maturities up to maximum of 1 year):

Investment	Minimum Credit Criteria	Use
UK Debt Management Agency Deposit Facility	UK Sovereign rating	In-house
Term deposits – local authorities	UK Sovereign rating	In-house
Term deposits – UK nationalised and part nationalised banks excluding Ulster Bank (part of RBS)	UK Sovereign rating	In-house & Fund Manager
Term deposits – banks and building societies	F1+, AA-, C, 1	In-house & Fund Manager
Certificates of deposit – UK nationalised and part nationalised banks excluding Ulster Bank (part of RBS)	UK Sovereign rating	In-house & Fund Manager
Certificates of deposit – banks and building societies	F1+, AA-, C, 1	In-house & Fund Manager
UK Treasury Bills	UK Sovereign rating	In house and Fund Manager
UK Government Gilts	UK Sovereign rating	In-house and Fund Manager
Bonds issued by multi-lateral development banks	AAA	In-house and Fund Manager
Sovereign bond issues (other than the UK govt)	AAA	In-house and Fund Manager

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Collective Investment Schemes structured as Open Ended Investment Companies (OEICs):		
1. Government Liquidity Funds	AAA	In-house and Fund Manager
2. Money Market Funds	Moody AAAmr+, Fitch AAAmmf, Standard and Poor AAAm	In-house and Fund Manager
3. Enhanced Cash Funds	AAA	In-house and Fund Manager
4. Bond Funds excluding corporate bonds	AAA	In-house and Fund Manager
5. Gilt Funds	AAA	In-house and Fund Manager

Non-specified Investments (any maturity and maturities in excess of 1 year):

Investment	**Minimum Credit Criteria**	**Use**	**Max duration to maturity**
Fixed term deposits with variable rate and variable maturities (structured deposits) – UK nationalised and part nationalised banks	UK Sovereign rating	In-house	2 years
Fixed term deposits with variable rate and variable maturities (structured deposits) – banks and building societies	F1+, AA-, C, 1	In-house	2 years
Term deposits – local authorities	UK Sovereign rating	In-house	2 years
Term deposits – UK nationalised and part nationalised banks excluding Ulster Bank (part of RBS)	UK Sovereign rating	In-house	2 years
Term deposits – banks and building societies	F1+, AA-, C, 1	In-house	2 years
Certificates of deposit – UK nationalised and part nationalised banks excluding Ulster Bank (part of RBS)	UK Sovereign rating	In-house and Fund Manager	2 years
Certificates of deposit – banks and building societies	F1+, AA-, C, 1	In-house and Fund Manager	2 years

Annex 1

Commercial paper – UK nationalised and part nationalised banks excluding Ulster Bank (part of RBS)	UK Sovereign rating	In-house and Fund Manager	2 years
Commercial paper – banks and building societies	F1+, AA-, C, 1	In-house and Fund Manager	2 years
Floating rate notes issued by multilateral development banks	AAA	Fund Manager	5 years
Bonds issued by multilateral development banks	AAA	In-house and Fund Manager	5 years
Sovereign bond issues (other than the UK Government)	AAA	In-house and Fund Manager	5 years
UK Government Gilts	UK Sovereign rating	In-house and Fund Manager	Max of 25% 5 years
UK Government Gilts	UK Sovereign rating	In-house and Fund Manager	Max of 25% 10 years

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

Appendix 7 Approved countries for investments

All counterparties in addition to meeting the minimum credit criteria specified in the Annual Investment Strategy must be regulated by a AAA sovereign rated as such by at least two of the three rating agencies (Fitch, Moody and Standard and Poor).

This list will be reviewed and amended if appropriate on a weekly basis by the Director of Finance.

As of 12 January 2011 sovereigns meeting the above requirement were:

Australia
Canada
Denmark
Finland
France
Germany
Luxembourg
Netherlands
Norway
Singapore
Sweden
Switzerland
U.K.
U.S.A.