Appendix I

Prudential Indicators 2009/10 to 2012/13

1. The Capital Expenditure Plans

1.1 The Council's gross capital expenditure plans are summarised below in Table A and this forms the first of the prudential indicators. Total expenditure is partially funded by resources such as capital receipts, capital grants, etc. Any remaining expenditure which cannot be immediately funded from other resources will form a borrowing need.

1.2 A certain level of capital expenditure will be grant supported by the Government; anything above this level will be unsupported and be paid for from the Council's own resources.

1.3 There are two main limiting factors which may impact on the Council's ability to undertake unsupported capital expenditure:

- Whether the revenue resource is available to support in full the implications of capital expenditure, both borrowing costs and running costs.

- The Government may use a control to limit either the total of all councils' plans nationally, or in the event of an assessment by central government that local plans are unaffordable at a specific council, it may implement a local control. No such control was implemented during 2009/10, however, this is a subject of current debate and the situation may change in the future.

1.4 The level of Government support has been provided as part of the settlement for the periods 2008/09 to 2010/11 and 2011/12 to 2013/14. A number of changes and amendments to the timing of capital funding have taken place since the Council was first advised of the level of support. These changes have been reflected in the prudential indicators and further changes cannot be ruled out. In addition some of estimates for other sources of funding, such as capital receipts, may be subject to change over this timescale.

1.5 The projections in Table A include the estimated impact of the capital value of the West Dunbartonshire Schools PPP project for 2009/10 and 2010/11 as required by the Prudential Code. This is the first time that PPP has been included and is a requirement due to the implementation of International Financial Reporting Standards (IFRS) in Local Authority accounting. The technical accounting impact of PPP will be incorporated into the Council's accounts for 2009/10 during the year end process. Once this process has been completed the projections as noted in Table A will be revised where the difference is material.

1.6 The projections in Table A also include the estimated impact relating to Consent to Borrow for Equal Pay as advised by the Scottish Government on 11 February 2010, pending Council decision.

1.7 The Council is asked to approve the summary capital expenditure projections incorporating both General Services and HRA in the table below:

Table A:

£000	2009/10 Revised	2010/11 Estimated	2011/12 Estimated	2012/13 Estimated
Capital Expenditure	**132,489**	**47,607**	**32,404**	**26,904**
Financed by:				
Capital receipts	8,053	8,845	4,400	4,438
Capital grants	9,723	5,654	6,512	6,642
Govt supported borrowing	5,070	5,070	5,070	5,070
Revenue	0	0	0	0
Net financing need for the year	**109,644**	**28,038**	**16,422**	**10,753**

1.8 The reduction in the projected GS and HRA net financing need for each future years over the 2009/10 revised level is due to the reduced impact of PPP in future years.

2. The Council's Borrowing Need (the Capital Financing Requirement)

2.1 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is a measure of the Council's underlying borrowing need. The net capital financing need (as indicated in Table A) will impact directly on the CFR. The Council is asked to approve the CFR projections below:

Table B:

£000	2009/10 Revised	2010/11 Estimated	2011/12 Estimated	2012/13 Estimated
Capital Financing Requirement				
CFR – Non Housing	212,945	221,421	222,961	222,961
CFR – Housing	93,703	101,154	103,559	103,559
Total CFR	**306,648**	**322,575**	**326,520**	**326,520**
Movement in CFR	99,437	15,927	5,708	0

2.2 The above projections ignore any adjustment in the CFR as required by the Prudential Code revision.

2.3 The expected impact of the capital expenditure decisions above on the Council's debt and investment position are shown in the Treasury Strategy (Appendix II).

3. Affordability Prudential Indicators

3.1 The previous sections cover the overall capital and control of borrowing, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These indicate the impact of the capital investment plans on the overall Council's finances. The Council is asked to approve the following indicators:

3.1.1 Actual and Estimates of the ratio of financing costs to net revenue stream – This indicator identifies the trend in the cost of capital (loan charges) against the net revenue stream (current projections on funding sources e.g. AEF and council tax). The estimates of financing costs include current commitments and the proposals in this budget report.

Table C:

	2009/10 Revised	**2010/11 Estimated**	**2011/12 Estimated**	**2012/13 Estimated**
Non-HRA	5.79%	6.36%	6.68%	7.03%
HRA	40.56%	40.98%	41.72%	42.11%

3.1.2 Estimates of the incremental impact of capital investment decisions on the Council Tax – This indicator identifies the trend in the cost of proposed changes in the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some elements which are estimated over the three year period.

Table D:

	Proposed Budget 2010/11	**Forward Projection 2011/12**	**Forward Projection 2012/13**
Council Tax - Band D	£1.85	£0.55	£0.70

3.1.3 **Estimates of the incremental impact of capital investment decisions on Housing Rent levels** – Similar to the council tax calculation this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in this budget report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

Table E:

	Proposed Budget 2010/11	**Forward Projection 2011/12**	**Forward Projection 2012/13**
Weekly Housing Rent levels	£1.48	£1.47	£0.98

Appendix II

Treasury Management Strategy 2010/11 – 2012/13

1. Background

1.1 The treasury management service is an important part of the overall financial management of the Council's affairs. Whilst the prudential indicators in Appendix I consider the affordability and impact of capital expenditure decisions, the treasury service covers the effective funding of these decisions. There are specific treasury prudential indicators included in this strategy which need approval.

1.2 The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management – revised November 2009). This Council adopted the Code of Practice on Treasury Management on 27 March 2002, and will adopt the revised Code.

1.3 As a result of adopting the Code, the Council also adopted a Treasury Management Policy Statement on 27 March 2002. This adoption is the requirements of one of the prudential indicators. However the revised Code of Practice has amended the Treasury Management Policy Statement and this is attached at Appendix III for approval.

1.4 The Council is also required to formally adopt four Treasury Management clauses as part of the Council's financial regulations and these are attached at Appendix IV for approval.

1.5 The policy requires an annual strategy to be reported to Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. A further report is produced after the year-end to report on actual activity for the year, and a new requirement of the revision of the Code of Practice is that there is a mid year monitoring report.

1.6 This strategy covers:

- The Council's debt and investment projections
- Limits to the Council's borrowing activity
- The economic climate and expected movement in interest rates
- The Council's borrowing, debt and investment strategies
- Treasury performance indicators
- Specific limits on treasury activities

2. The Council's debt and investment projections

2.1 The borrowing requirement comprises the expected movement in the CFR and any maturing debt which will need to be re-financed. The projections of external borrowing and anticipated investments for 2009/10 to 2012/13 is as noted in Table F, and takes account of expected capital expenditure and annual repayments in each year. The expected maximum debt position during each year represents the Operational Boundary prudential indicator; it is not a limit. Actual external debt could vary around this boundary for short times during the year.

Table F:

£000	2009/10 Revised	2010/11 Estimated	2011/12 Estimated	2012/13 Estimated
External Debt				
Debt at 1 April	215,440	308,448	324,431	328,430
Early Repayment of Debt	(6,500)	0	0	0
Maturing Debt	(25,019)	(20,079)	(36)	(1,037)
New Borrowing : Maturing Debt	25,000	20,045	0	1,000
New Borrowing : CFR	99,527	16,017	4,036	0
Debt at 31 March	**308,448**	**324,431**	**328,430**	**328,393**
Annual Change in Debt	93,008	15,983	4,000	(37)
Operational Boundary	**339,292**	**356,874**	**361,273**	**361,232**
Investments				
Total Investments at 1 April	26,221	5,221	5,221	5,221
Annual Change in Investments	(21,000)	0	0	0
Total Investments at 31 March	5,221	5,221	5,221	5,221

3. Limits to Borrowing Activity

3.1 Within the prudential indicators there are a number of key indicators to ensure the Council operates its activities within well defined limits.

3.2 For the first of these, the Council needs to ensure that its total debt (net of any investments) does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2010/11 and next two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes. Table G compares the estimated net debt and the CFR.

Table G:

£000	2009/10 Revised	2010/11 Estimated	2011/12 Estimated	2012/13 Estimated
Gross Debt	308,448	324,431	328,430	328,393
Investments	5,221	5,221	5,221	5,221
Net Debt	303,227	319,210	323,209	323,172
CFR	306,648	322,575	326,520	326,520

3.3 The Executive Director of Corporate Services reports that the Council has complied with this prudential indicator, and no difficulties are envisaged for the current or future years. This view takes into account current commitments, existing plans, and the proposals in the 2010/11 capital plan.

3.4 The Authorised Limit for External Debt – a further key prudential indicator represents a control on the overall level of borrowing. This represents a limit beyond which external debt is not allowed to exceed. This needs to be set or revised by Members. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

3.5 The Council is asked to approve the following authorised limit:

Table H (£000):

Authorised limit for external debt	2009/10 Revised	2010/11 Estimated	2011/12 Estimated	2012/13 Estimated
External Debt	370,137	339,292	394,116	391,990

3.6 Advance Borrowing - This Council will not borrow more than or earlier than required with the prime intention to profit from the investment return of the extra sums borrowed.

3.6.1 Advance borrowing will only be taken for risk management purposes subject to sound justification. The Executive Director of Corporate Services may do this under delegated power where, for instance, a sharp rise in interest rates is expected and so borrowing early at fixed interest rates will be economically beneficial. A cautious approach to any such borrowing will be adopted, however where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities.

3.6.2 Full consideration will be give to balancing investment risks, such as the credit and interest risk resulting from the temporary investment of the sums, against the risk of adverse interest rate movements in addition to the existing debt maturity profile over the medium term.

3.6.3 As required by the Draft Local Government Investments (Scotland) Regulations 2010 (discussed further in section 6.1 below) the Council will appraise all risks associated with advance borrowing activity. Justification for the decision prior to the activity being undertaken will be fully documented, with subsequent reporting either within the mid year or annual reporting mechanism. This report will comply with the minimum data and analytical requirements outlined with the draft regulations, subject to their final approval by the Scottish Government.

4. Economic Indicators

4.1 Short Term Interest Rates - Short-term rates are expected to remain on hold for a considerable time. The recovery in the economy has commenced but it is expected to have little movement and there is a danger that early reversal of monetary ease, (e.g. rate cuts) could trigger a dip back to negative growth.

4.2 Business and personal credit extensions have improved modestly but banks remain nervous about the viability of counterparties. This is likely to remain a limiting factor on activity prospects.

4.3 The main limiting factor on the economy is expected to be weak consumers' expenditure growth. The combination of the desire to reduce the level of personal debt and job uncertainty is likely to limit spending. This will be amplified by the prospective increases in taxation already scheduled for 2010 – VAT and National Insurance. Without a rebound in this key element of UK GDP growth, any recovery in the economy is set to be weak and protracted.

4.4 The Monetary Policy Committee (MPC) will continue to promote easy credit conditions.

4.5 With inflation set to remain subdued in the next few years (though a sharp blip is forecast for the next few months), the pressure upon the MPC to increase rates will remain moderate. But some increase will be seen as necessary in 2010 to counter the effects of external cost pressures.

4.6 Longer Term Interest Rates - The outlook for long-term fixed interest rates is a lot less favourable. While the UK's fiscal burden should ease in the future, this will be a lengthy process and deficits over the next few financial years will require a very heavy programme of gilt issuance.

4.7 This may end in the short term, especially if the economy has returned to a recovery path as seems very likely. With growth back on the agenda and inflation challenging the upper limit of the Government's target range, the majority of MPC members may feel enough assistance has been given to ensure lack of credit is no longer a fundamental threat to the welfare of the economy

4.8 The absence of the Bank of England as the largest buyer of gilts will shift the balance between supply and demand in the gilt-edged market. Other investors will require some incentive to continue buying government paper.

4.9 This incentive will take the form of higher interest rates. Longer term fixed interest rates will suffer from the lack of support from the major savings institutions – pension funds and insurance companies - who will continue to favour other investment instruments as a source of value and performance. The shorter fixed interest rates will be pressured higher by the impact of rising money market rates. While bank purchases in this part of the market will continue to feature as these institutions meet regulatory obligations, this process will be insufficiently strong to resist the upward trend in yields.

4.10 Table I identifies the current forecast on medium term interest rates:

Table I:

Annual Average %	Bank Rate	PWLB Rates*		
		5 year	20 year	50 year
2009/10	0.5	1.4	4.4	4.6
2010/11	1.0	2.3	5.0	5.2
2011/12	2.0	3.3	5.3	5.3
2012/13	4.5	5.3	5.5	5.3

Source: Butlers' Medium Term UK rate forecasts – Annual Average (January 2010)
* Borrowing Rates

5. Borrowing and Debt Strategy 2009/10 – 2011/12

5.1 The uncertainty over future interest rates increases the risks associated with treasury activity and as a result the Council will take a cautious approach to its treasury strategy.

5.2 Long-term fixed interest rates are at risk of being higher over the medium term, and short term rates are expected to rise, although more modestly. The Executive Director of Corporate Services, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above. It is likely that shorter term fixed rates may provide lower cost opportunities in the short/medium term.

5.3 With the likelihood of long term rates increasing, debt restructuring is likely to focus on switching from longer term fixed rates to cheaper shorter term debt, although the Executive Director of Corporate Services and treasury consultants will monitor prevailing rates for any opportunities during the year.

5.4 The option of postponing borrowing and running down investment balances will also be considered. This would reduce counterparty risk and hedge against the expected fall in investments returns

6. Investment Strategy

6.1 Draft Local Government Investments (Scotland) Regulations 2010 – Draft regulations (SSI2010/draft) were laid before the Scottish Parliament on 11 February 2010 for discussion by the Local Government and Communities Committee on 24 February 2010.

6.1.1 It is anticipated that the regulations will come into force on 1 April 2010 therefore the revised guidance arising from these regulations has been incorporated with limitations that these will only be implemented once the Regulations are approved. Until this time the Council will continue the current policy – maintaining all investments less than one year and avoiding money market funds, Gilts, etc.

6.1.2 If necessary the Investment Strategy will be revised if any elements of the final Investment Regulations change.

6.2 Key Objectives - Following the economic background above, the current investment climate has one over-riding risk consideration - that of counterparty security risk. As a result of these underlying concerns, officers are implementing an operational investment strategy which tightens the controls already in place in the approved investment strategy. The Council's investment strategy primary objectives are safeguarding the re-payment of the principal and interest of its investments on time first and ensuring adequate liquidity second – the investment return being a third objective. After this main principle the Council will ensure:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security.

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

6.3 Investment Strategy – The process for investment strategy under the draft regulations covers a wide range of Council investments and will be broadly managed in the following way:

- Short Term Cash – Cash relating to day to day cash flow will be maintained on a shorter term basis in cash type products with consideration to the liquidity requirements outlined above.

- Longer Term Cash – Cash relating to reserves, provisions and balances on the balance sheet may be held for longer periods of time in cash type products, or alternatively placed with a fund manager or in longer term bonds or funds depending on:

  - Cash flow requirements:
  - The underlying expectation for interest rates; and
  - The economic background of these investments may be held longer term.

- Service Type Investments – These types of investments will predominately be policy driven and approved by Members. Loans to third parties (and equity instruments, and investment properties held for rental returns) will be regularly reviewed to judge the investment performance.

6.4 Risk Benchmarking – A development in the revised Code is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are new requirements, although the application of these is more subjective in nature.

6.4.1 These benchmarks are simply targets (not limits) and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy depending on any changes. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

6.4.2 In the context of benchmarking, assessing security is a very subjective area to assess. Security is currently evidenced by the application of minimum quality criteria to investment counterparties, primarily through the use of credit ratings supplied by the three main credit rating agencies (Fitch, Moody's and Standard and Poors). Whilst this approach embodies security considerations, benchmarking levels of risk is more problematic. One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council's investment strategy. Table J shows average defaults for differing periods of investment grade products for each Fitch long term rating category over the period 1990 to 2007.

Table J:

Long term rating	1 year	2 years	3 years	4 years	5 years
AAA	0.00%	0.00%	0.00%	0.00%	0.00%
AA	0.00%	0.00%	0.00%	0.03%	0.06%
A	0.03%	0.15%	0.30%	0.44%	0.65%
BBB	0.24%	0.78%	1.48%	2.24%	3.11%

6.4.3 The Council's minimum long term rating criteria is currently "A-", meaning the average expectation of default for a one year investment in a counterparty with a "A" long term rating would be 0.03% of the total investment (e.g. for a £1m investment the average loss would be £300). This is only an average - any specific counterparty loss is likely to be higher - but these figures do act as a benchmark for risk across the portfolio.

6.4.4 As required by the CIPFA Treasury Management Code of Practice the Council will "ensure that it has adequate, though not excessive, cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives". In respect to liquidity as defined above the Council seeks to maintain:

- Bank overdraft limit - £1m
- Liquid short term deposits of at least £5m available on an overnight basis.

6.4.5 Local measures of yield investment benchmarks that will be used to assess returns are:

- Internal returns above the 7 day LIBID rate
- Internal returns above the 1 month LIBID rate for fixed investments
- Internal returns above the Council's tracker account

6.4.6 All external cash type investments will be monitored as noted in 6.4.2 above. These exclude investment properties, third party loans and local authority investment companies. The procedures for reviewing these holdings are:

- Investment Properties – The portfolio of investment properties (value, gross and net yield) will be reviewed annually against the Investment Strategy limits are reported in the Annual Investment Report.

- Third Party Loans – Details of all third party loans by value and interest rate will be summarised in the Annual Investment Report, with an assessment of likely recovery.

- Local authority companies – Details of all local authority equity and loan capital by value and, where applicable interest rate, will be summarised in the Annual Investment Report, with an assessment of likely recovery/performance.

6.5 Council Permitted Investments – The draft Local Government Investments (Scotland) Regulations 2010 requires Council approval of all the types of investment to be used and set appropriate limits for the amount that can be held for each investment type. These types of investment are termed permitted investments and any investments used which have not been approved as a permitted investment will be considered ultra vires.

6.5.1 The permitted investments which may be used in the forthcoming year are noted below. Details of the risks, mitigating controls and limits associated with each of these permitted categories are shown in Appendix V.

- Cash Type Instruments

  - Deposits with the Debt Management Account Facility (UK Government);
  - Deposits with other local authorities or public bodies;
  - Money Market Funds;
  - Call accounts, deposit accounts with financial institutions (banks and building societies;
  - Term deposits with financial institutions (banks and building societies);
  - UK Government Gilts and Treasury Bills;
  - Certificates of deposits will financial institutions (banks and building societies);
  - Structured deposit facilities with banks and building societies (escalating rates, de-escalating rates, etc);

- Other Investments

  - Investment properties;
  - Loans to third parties, including soft loans;
  - Loans to a local authority company;
  - Shareholding in a local authority company;
  - Non-local authority shareholdings

6.5.2 Permitted investments related to the Common Good are also shown in Appendix V, and where applicable the same counterparty selection criteria as noted in 6.6 below will be applied.

6.6 Investment Counterparty Selection Criteria - The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Council will ensure:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security.

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

6.6.1 The Executive Director of Corporate Services will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. This criteria selects which counterparties the Council will choose from, rather than defining what its investments are.

6.6.2 The rating criteria use the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria. This is in compliance with a CIPFA Treasury Management Panel recommendation in March 2009 and the CIPFA Treasury Management Code of Practice. Credit rating type and definitions are attached as Appendix VI.

6.6.3 Credit rating information is supplied by our treasury consultants on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, notification of likely changes or rating outlooks are provided to officers almost immediately after they occur and this information is considered before dealing.

6.6.4 The criteria for providing a pool of high quality investment counterparties is:

- Category 1 - Good Credit Quality – the Council will only use financial institutions which:

  - Are UK banks; and/or
  - Are non-UK and domiciled in a country which has a minimum Sovereign long term rating of AAA
  - And have, as a minimum, the following Fitch, Moody's and Standard and Poors (S&P) credit ratings (where rated):
    a) Short Term – F1 (or equivalent from Fitch, Moody's and S&P)
    b) Long Term – A- (or equivalent from Fitch, Moody's and S&P)
    c) Individual / Financial Strength – C (Fitch / Moody's only)
    d) Support – 3 (Fitch only)
  - The difference between the ratings will be reflected in the money limits as noted in Table L

- Category 2 - Guaranteed Banks with suitable Sovereign Support – In addition, the Council will use banks whose ratings fall below the criteria specified above if all of the following conditions are met:

  - Wholesale deposits in the bank are covered by a government guarantee;
  - The government providing the guarantee is rated "AAA" by all three major rating agencies (Fitch, Moody's and Standard & Poors); and
  - The Council's investments with the bank are limited to amounts and maturities within the terms of the stipulated guarantee.

- Category 3 - Eligible Institutions – The Council will use banks whose Individual / Financial Strength and Support ratings fall below the criteria specified in category 1, if the organisation is an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008. The inclusion of these banks in the counterparty list is subject to the requirement that both the minimum short and long term ratings specified in category 1 are achieved. These institutions have been subject to suitability checks before inclusion, and have access to HM Treasury liquidity if needed.

- Category 4 - The Council's own banker for transactional purposes if the bank falls below the above criteria specified in category 1, although in this case balances will be minimised in both monetary size and time.

- Category 5 - Bank Subsidiary and Treasury Operations – the Council will use these where the parent bank has the necessary ratings outlined in category 1.

- Category 6 - Building Societies – the Council will use all Societies which meet the ratings for banks outlined in category 1.

- Category 7 - Money Market Funds – the Council will use money market funds that are AAA rated.

- Category 8 - UK Government (including gilts and the DMADF)

- Category 9 - Local Authorities, etc

6.6.5 Due to the uncertainty in the financial markets it is recommended that the Investment Strategy is approved which will provide officers with the flexibility to deal with any unexpected occurances. Officers can restrict the pool of available counterparties from this criteria to safer instruments and institutions.

6.6.6 The time limits for institutions on the Council's counterparty list are as noted in Table K:

Table K:

Investment Category	Fitch (or equivalent)	Money Limit	Time Limit
1	F1+ / AA-	£10million	364 days
	F1 / A-	£5million	
2		£5 million	Lower of 364 days & duration of HM Treasury Credit Guarantee scheme
3		£10 million / £5 million	Lower of 364 days & duration of Sovereign Guarantee scheme
4		£5 million	Overnight
5		£5 million	6 months
6		£10 million	364 days
7		£10 million	Very liquid no time limit applies
9		£10 million	364 days

6.6.7 The Council's bankers are currently the Clydesdale Bank Plc which falls within Category 3 – Eligible Institutions. It is recognised that the money limit of £10million or £5million (depending on the minimum rating) may be breached for purely operational purposes on a temporary overnight basis only. Corporate Finance will endeavour to avoid this scenario but this allows for circumstances that are outwith the Council's control where funds may be deposited unexpectedly or at short notice into the Council's accounts after the dealing deadline for the day has passed. In such a circumstance the funds will require to be kept on an overnight basis in the Council's bank account until appropriate arrangements can be made for investment.

6.6.8 Table K does not include time and money limits for category 8 which are funds deposited with the UK Government namely the Debt Management Account Deposit Facility (DMADF). This facility allows local authorities to deposit surplus cash on flexible terms and receive a market related rate of interest. Funds are held by the Bank of England and the scheme carried the Government's own sovereign AAA credit rating offering the highest available security and therefore no maximum limits have been set.

6.6.9 Country and sector considerations - Due care will be taken to consider the country, group and sector exposure of the Council's investments. In part the country selection will be chosen by the credit rating of the Sovereign state in Banks 1 above. In addition:

- No more than 25% will be placed with any non-UK country at any time;
- Limits in place above will apply to Group companies;
- Sector limits will be monitored regularly for appropriateness.

6.6.10 Use of additional information other than credit ratings – Additional requirements under the Code of Practice now require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information will be applied to compare the relative security of differing investment counterparties.

6.6.11 Economic Investment Considerations - Expectations on shorter-term interest rates, on which investment decisions are based, show likelihood of the current 0.5% Bank Rate remaining flat but with the possibility of a rise in mid-2010. The Council's investment decisions are based on comparisons between the rises priced into market rates against the Council's and advisers own forecasts.

6.6.12 There is an operational difficulty arising from the current banking crisis. There is currently little value investing longer term unless credit quality is reduced. Whilst some selective options do provide additional yield uncertainty over counterparty creditworthiness suggests shorter dated investments would provide better security.

6.6.13 The criteria for choosing counterparties set out above provide a sound approach to investment in "normal" market circumstances. Whilst Members are asked to approve this base criteria above, under the exceptional current market conditions the Executive Director of Corporate Services may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval. These restrictions will remain in place until the banking system returns to "normal" conditions. Similarly the time periods for investments will be restricted.

6.6.14 Examples of these restrictions would be the greater use of the Debt Management Deposit Account Facility (DMADF – a Government body which accepts local authority deposits), Money Market Funds, guaranteed deposit facilities and strongly rated institutions offered support by the UK Government. The credit criteria have been amended to reflect these facilities.

6.7 Sensitivity to Interest Rate Movements - Future Council Financial Statements will be required to disclose the impact of risks on the Council's treasury management activity. Whilst most of the risks facing the treasury management service are addressed elsewhere in this report (credit risk, liquidity risk, market risk, maturity profile risk), the impact of interest rate risk is discussed but not quantified. Table L highlights the estimated impact of a 1% increase/decrease in all interest rates to the estimated treasury management costs/income for next year. That element of the debt and investment portfolios which are of a longer term, fixed interest rate nature will not be affected by interest rate changes.

Table L:

Loan Type	2010/11 Estimate	2010/11 Estimated + 1%	2010/11 Estimated - 1%
Revenue Budgets			
Variable Rate Debt Payments	£0.005m	+£0.004m	-£0.004m
Variable Rate Investment income	£0.042m	+£0.054m	-£0.042m

7. Treasury Management Limits on Activity

7.1 There are four further treasury activity limits, which were previously prudential indicators. The purpose of these prudential indicators is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs.

- *Upper limits on variable interest rate exposure* – This indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments

- *Upper limits on fixed interest rate exposure* – Similar to the previous indicator this covers a maximum limit on fixed interest rates.

- *Maturity structures of borrowing* – These limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

- *Total principal funds invested for greater than 364 days* - These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

7.2 The proposed indicators are shown within Table M:

Table M:

	2009/10 Upper		**2010/11 Upper**		**2011/12 Upper**	
Limits on fixed interest rates	100%		100%		100%	
Limits on variable interest rates	30%		30%		30%	
Maturity Structure of fixed interest rate borrowing						
	Lower	**Upper**	**Lower**	**Upper**	**Lower**	**Upper**
Under 12 months	0%	15%	0%	15%	0%	15%
12 months to 2 years	0%	15%	0%	15%	0%	15%
2 years to 5 years	0%	30%	0%	30%	0%	30%
5 years to 10 years	0%	50%	0%	50%	0%	50%
10 years to 20 years	0%	50%	0%	50%	0%	50%
20 years to 30 years	0%	50%	0%	50%	0%	50%
30 years to 40 years	0%	50%	0%	50%	0%	50%
40 years to 50 years	0%	100%	0%	100%	0%	100%
50 years to 60 years	0%	100%	0%	100%	0%	100%
60 years to 70 years	0%	100%	0%	100%	0%	100%
Currently principal sums invested > 364 days	£nil		£nil		£nil	

8. Performance Indicators

8.1 The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. Examples of performance indicators often used for the treasury function are:

- Debt – Borrowing - Average rate of borrowing for the year compared to average available
- Debt – Average rate movement year on year
- Investments – Internal returns above the 7 day LIBID rate

8.2 The results of these indicators will be reported in the Treasury Annual Report for 2009/10.

9. Treasury Management Advisers

9.1 The Council currently uses Butlers as its treasury management consultants. The company provides a range of services which include:

- Technical support on treasury matters, capital finance issues and the drafting of Member reports;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments;
- Credit ratings/market information service comprising the three main credit rating agencies;

9.2 Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice the final decision on treasury matters remains with the Council. This service is subject to regular review.

10. The Monitoring of Investment Counterparties

10.1 The credit rating of counterparties will be monitored regularly. The Council receives credit rating information from Butlers as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Executive Director of Corporate Services, and if required new counterparties which meet the criteria will be added to the list.

11. Member and Officer Training

11.1 The increased Member consideration of treasury management matters and the need to ensure officers dealing with treasury management are trained and kept up to date requires a suitable training process for Members and officers.

Appendix III

West
Dunbartonshire
Council

WEST DUNBARTONSHIRE COUNCIL

TREASURY MANAGEMENT
POLICY STATEMENT

The Council defines its treasury management activities as:

"*the management of the organisation's cash flows, its banking, money markets and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks*".

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 the risk implications for the Council.

The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principle of achieving value for money in treasury management, and to employing suitable and comprehensive performance measurement techniques, within the context of effective risk management.

Appendix IV

West
Dunbartonshire
Council

WEST DUNBARTONSHIRE COUNCIL

TREASURY MANAGEMENT
CLAUSES TO BE FORMALLY ADOPTED

1. This 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 (TMP's), 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.

2. 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 TMP's.

3. The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to the Corporate and Efficient Governance Committee, and for the execution and administration of treasury management decisions to the Executive Director or Corporate Services, who will act in accordance with the Council's Treasury Policy Statement and TMP's and CIPFA's Standard of Professional Practice on Treasury Management.

4. The organisation nominates the Audit and Performance Review Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

Appendix V

West Dunbartonshire Council and Common Good Funds Permitted Investments, Associated Controls and Limits

Type of Investment	Treasury Risks	Mitigating Controls	Council and Common Good Limits
Cash Type Instruments			
(a) Deposits with the Debt Management Account Facility (UK Government) (Very low risk)	This is a deposit with the UK Government and as such counterparty and liquidity risk is very low, and there is no risk to value. Deposits can be between overnight and 6 months.	Little mitigating controls required. As this is a UK Government investment the monetary limit is unlimited to allow for a safe haven for investments.	£unlimited, maximum 6 months.
(b) Deposits with other (individual) local authorities or public bodies (Very low risk)	These are considered quasi UK Government debt and as such counterparty risk is very low, and there is no risk to value. Liquidity may present a problem as deposits can only be broken with the agreement of the counterparty, and penalties can apply. Deposits with other non-local authority bodies will be restricted to the overall credit rating criteria.	Little mitigating controls required for local authority deposits, as this is a quasi UK Government investment. Non- local authority deposits will follow the approved credit rating criteria.	£10million - maximum of 3 years.
(c) Money Market Funds (MMFs) (Very low risk)	Pooled cash investment vehicle which provides very low counterparty, liquidity and market risk. These will primarily be used as liquidity instruments.	Funds will only be used where the MMFs are Constant Net Asset Value (CNAV), and the fund has a “AAA” rated status from either Fitch, Moody’s or Standard & Poors.	£10million Very liquid no time limit applies

Type of Investment	Treasury Risks	Mitigating Controls	Council and Common Good Limits
(d) Call account deposit accounts with financial institutions (banks and building societies) (Low risk depending on credit rating)	These tend to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is no risk to value with these types of investments, liquidity is high and investments can be returned at short notice.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poors. The selection defaults to the lowest available credit rating to provide additional risk control measures. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in the counterparty section criteria 6.6.6 above
(e) Term deposits with financial institutions (banks and building societies) (Low to medium risk depending on period & credit rating)	These tend to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is no risk to value with these types of investments, liquidity is low and term deposits can only be broken with the agreement of the counterparty, and penalties may apply.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poors. The selection defaults to the lowest available credit rating to provide additional risk control measures. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in the counterparty section criteria 6.6.6 above.
(f) Government Gilts and Treasury Bills (Very low risk)	These are marketable securities issued by the UK Government and as such counterparty and liquidity risk is very low, although there is potential risk to value arising from an adverse movement in interest rates (no loss if these are held to maturity.	Little counterparty mitigating controls are required, as this is a UK Government investment. The potential for capital loss will be reduced by limiting the maximum monetary and time exposures.	£10million - maximum of 3 years.

Type of Investment	Treasury Risks	Mitigating Controls	Council and Common Good Limits
(g) Certificates of deposits with financial institutions (Low risk)	These are short dated marketable securities issued by financial institutions and as such counterparty risk is low, but will exhibit higher risks than categories (a), (b) and (c) above. There is risk to value of capital loss arising from selling ahead of maturity if combined with an adverse movement in interest rates. Liquidity risk will normally be low.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poors. The selection defaults to the lowest available credit rating to provide additional risk control measures. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in the counterparty section criteria 6.6.6 above.
(h) Structured deposit facilities with banks and building societies (escalating rates, de-escalating rates etc.) **(Low to medium risk depending on period & credit rating)**	These tend to be medium to low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is no risk to value with these types of investments, liquidity is very low and investments can only be broken with the agreement of the counterparty (penalties may apply).	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poors. The selection defaults to the lowest available credit rating to provide additional risk control measures. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in the counterparty section criteria 6.6.6 above.
Other Types of Investment			
(i) Investment properties	These are non-service properties which are being held pending disposal or for a longer term rental income stream. These are highly illiquid assets with high risk to value (the potential for property prices to fall or for rental voids).	In larger investment portfolios some small allocation of property based investment may counterbalance/compliment the wider cash portfolio. Property holding will be re-valued regularly and reported annually with gross and net rental streams.	Services will determine monetary and time limits managing risk accordingly.

Type of Investment	Treasury Risks	Mitigating Controls	Council and Common Good Limits
(j) Loans to third parties, including soft loans	These are service investments either at market rates of interest or below market rates (soft loans). These types of investments may exhibit credit risk and are likely to be highly illiquid.	Each third party loan requires Member approval and each application is supported by the service rational behind the loan and the likelihood of partial or full default.	Services will determine monetary and time limits managing risk accordingly.
(k) Loans to a local authority company	These are service investments either at market rates of interest or below market rates (soft loans). These types of investments may exhibit credit risk and are likely to be highly illiquid.	Each loan to a local authority company requires Member approval and each application is supported by the service rational behind the loan and the likelihood of partial or full default.	Services will determine monetary and time limits managing risk accordingly.
(l) Shareholdings in a local authority company	These are service investments which may exhibit market risk and are likely to be highly illiquid.	Each equity investment in a local authority company requires Member approval and each application will be supported by the service rational behind the investment and the likelihood of loss.	Services will determine monetary and time limits managing risk accordingly.
(m) Non-local authority shareholdings	These are non-service investments which may exhibit market risk, be only considered for longer term investments and will be likely to be liquid.	Any non-service equity investment will require separate Member approval and each application will be supported by rational behind the service the investment and the likelihood of loss.	Services will determine monetary and time limits managing risk accordingly.

The Monitoring of Investment Counterparties - The status of counterparties will be monitored regularly. The Council receives credit rating and market information from Butlers, including rating changes, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Executive Director of Corporate Services, and if required new counterparties which meet the criteria will be added to the list.

Appendix VI

Type of Rating	Rating	Explanation
Fitch -Short Term	F1+	Indicates exceptionally strong capacity for timely payment of financial commitments
	F1	Indicates strong capacity for timely payment of financial commitments
Fitch - Long Term	AA-	Indicates very strong capacity for timely payment of financial commitments and this capacity is not significantly vulnerable to foreseeable events
	A-	Indicates strong capacity for timely payment of financial commitments. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings
Moody's - Short Term	P-1	Banks based Prime-1 for deposits offer superior credit quality and a very strong capacity for timely payment of short term deposit obligations
Moody's - Long Term	Aa	Offer excellent credit quality, with susceptibility to long term risks with a vulnerability to greater fluctuations within protective elements
	A	Offer excellent credit quality, but elements suggest a Susceptibility to impairment over the long term
Standard & Poors - Short Term	A-1	Indicates a strong capacity to meet institutions financial commitments. Within this category, certain obligors are designated with a plus sign (+). This indicates that the obligor's capacity to meet its financial commitments is EXTREMELY STRONG
Standard & Poors - Long Term	AA-	Indicates strong capacity for timely payment of financial commitments
	A-	Indicates strong capacity for timely payment of financial commitments. This capacity may, nevertheless, be more susceptible to the adverse effects of changes in circumstances or in economic conditions than is the case for higher rated category