

GWENT POLICE AUTHORITY

ANNUAL TREASURY MANAGEMENT STRATEGY STATEMENT 2009/10

1 INTRODUCTION

- 1.1 Treasury Management is the management of cash flows, banking, money market and capital market transactions; the management of the associated risks, and the pursuit of the optimum performance or return consistent with those risks.
- 1.2 Under the conditions of the CIPFA Code of Practice on Treasury Management adopted by the Authority on 28 May 2004 there is a requirement to consider, prior to the start of the financial year, an annual Treasury Management Strategy Statement. The 2003 Prudential Code for Capital Finance in Local Authorities introduced new requirements for the manner in which capital spending plans are to be considered and approved, and in conjunction with this, the development of an integrated treasury management strategy.
- 1.3 The Prudential Code requires the Authority to set a number of Prudential Indicators, certain of which replace the borrowing/variable interest rate limits previously determined, whilst also extending the period covered from one to three years. This statement incorporates the Prudential Indicators and the Treasury Management Strategy for 2009/10.

2 TREASURY MANAGEMENT OPERATION

- 2.1 The approved activities of the Treasury Management operation are as follows:
 - a) Cash flow management (daily balances and longer term forecasting)
 - b) Investing surplus funds in approved Investments
 - c) Borrowing for cash flow purposes
 - d) Funding of capital payments through borrowing, capital receipts, grants or revenue contribution
 - e) Management of debt (including re-scheduling and monitoring an even maturity profile)
 - f) Interest rate exposure management
 - g) Dealing procedures with brokers, banks and the Public Works Loan Board

2.2 The Authority's portfolio as at 31st January 2009 was:

PRUDENTIAL INDICATORS FOR TREASURY MANAGEMENT	2008/09	2009/10	2010/11	2011/12
	£'000	£'000	£'000	£'000
Authorised limit for external debt -				
borrowing	18,745	28,876	28,876	28,876
other long term liabilities	0	0	0	0
TOTAL	18,745	28,876	28,876	28,876
Operational boundary -				
borrowing	7,814	25,876	25,876	25,876
other long term liabilities	0	0	0	0
TOTAL	7,814	25,876	25,876	25,876
Upper limit for fixed interest rate exposure				
Net principal re fixed rate borrowing / investments	-	100%	100%	100%
Upper limit for variable rate exposure				
Net principal re variable rate borrowing / investments	-	35%	35%	35%
Upper limit for total principal sums invested for over 364 days (per maturity date)				
	-	0	0	0

The average rate of interest on borrowing of 6.23% is higher than current rates as the loans were agreed at fixed rates several years ago. On the other hand, debt of £6m is relatively low compared to assets owned. The estimated average interest rate to be earned on investments of 1.4% compares with a figure of 6.2% reported in the Treasury Management Strategy for 2008-09. The reduction reflects the significant reductions in Base Rate over recent months, the more cautious investment strategy operated as a result of the worldwide banking crisis and the fact that specified investments do not exceed a one year period.

Investments are expected to reduce by approximately £14m over the next three years as a result of planned utilisation of reserves.

2.3 An analysis of the Capital Programme shows that the borrowing requirement (including that required for the Estates Strategy which is not shown in the Capital Programme) for the next 3 years is likely to be:

2008/09		2009/10	2010/11	2011/12
£'000		£'000	£'000	£'000
0	New borrowing	4,274	11,274	5,274
0	Replacement borrowing	0	0	0
0	Alternative financing arrangements	0	0	0
0	TOTAL	4,274	11,274	5,274

3.0 TREASURY MANAGEMENT STRATEGY

3.1 Objectives

The major treasury management objectives for 2009/10 are:-

(a) Borrowing

- To minimise the revenue costs of debt.
- To manage the Authority's debt maturity profile i.e. to leave no one future year with a high level of repayments that could cause problems in re-borrowing. (the current debt maturity profile is shown on **page 10**).
- To effect funding in any one year at the cheapest cost commensurate with future risk.
- To forecast average future interest rates and borrow accordingly.
- To monitor and review the level of variable interest rate loans in order to take greater advantage of interest rate movements.

(b) Investment

- To maintain capital security
- To achieve maximum returns commensurate with acceptable risk

3.2 Forecasts for 2009/10

3.2.1 Prospects for Interest Rates

A year ago the Bank of England Base Rate stood at 5.25%, and our treasury management advisors were predicting average rates in 2008-09 and 2009-10 of 4.8%, increasing in 2010-11 to 5.0%. The rate dropped on 10 April 2008 to 5% and remained steady at that rate for six months. Then, in October 2008, the situation in the global banking world entered a period of turmoil and the Base Rate tumbled in five monthly steps to a rate announced on 5 February 2009 of 1%. The average base rate for the year 2008-09, assuming no changes between now and the end of March 2009, will be approximately 3.8%.

3.2.2 The UK economy has entered a profound recession, worsened by a dangerous combination of negative growth and dislocation in the domestic and world financial markets. The situation in the economy is considered critical by the policy setters who are concerned that the testing financial environment, the sharp decline in house prices and persistently tight credit

conditions could trigger a collapse in consumer confidence. At best this could deliver a short, sharp downturn, at worst a prolonged Japanese-style recession.

- 3.2.3 The sharp downturn in world commodity, food and oil prices, the lack of domestic wage pressures and weak retail demand promises a very steep decline in inflation in the year ahead. In the recent pre-Budget Report, the Treasury suggested RPI inflation could fall to minus 2.25% by September 2009. Inflation considerations will not be a constraint upon Bank of England policy action. Indeed, the threat of deflation strengthens the case for more aggressive policy ease.
- 3.2.4 The Government's November pre-Budget Report did feature some fiscal relaxation but it also highlighted the very poor health of public sector finances. The size of the package is considered insufficient to kick-start the economy. The onus for economic stimulation will fall upon monetary policy and the Bank of England.
- 3.2.5 The Bank will continue to ease policy and the need to drive commercial interest rates, currently underpinned by the illiquidity of the money market, to much lower levels suggests the approach will be more aggressive than might otherwise have been the case. A Bank Rate below 1% now seems a distinct possibility and short-term LIBOR rates of below 2% may result. Only when the markets return to some semblance of normality will official rates be edged higher.
- 3.2.6 Long-term interest rates will be the victim of conflicting forces. The threat of deep global recession should drive bond yields to yet lower levels and this will be a favourable influence upon the sterling bond markets. But the prospect of exceptionally heavy gilt-edged issuance in the next three years (totalling in excess of £100bn per annum), as the Government seeks to finance its enormous deficit, could severely limit the downside potential for yields.
- 3.2.7 Treasury Management is a specialist area and most police authorities either appoint or have access to advice from specialist advisors, to assist day to day internal decision making and in formulating longer-term strategies. This Authority use Butlers as specialist treasury management advisors. The following table shows expected average interest rates as provided by Butlers:

Year	Bank Rate	Money Rates		PWLB Rates		
		3 month	1 year	5 year	20 year	50 year
2008/09	3.9	5.0	5.3	4.2	4.8	4.5
2009/10	1.0	1.6	1.8	2.4	3.9	3.8

2010/11	1.7	2.1	2.8	3.2	4.1	4.0
2011/12	2.4	2.8	3.6	4.0	4.3	4.1

Capital Borrowings and the Borrowing Portfolio Strategy

- 3.2.8 The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Authority will take a cautious approach to its treasury strategy.
- 3.2.9 The Treasurer will take the most appropriate form of borrowing, taking into account prevailing interest rates at the time and the risk of rate changes.
- 3.2.10 The Treasurer will endeavour to achieve the optimum funding structure for the Capital Programme, maximising the use of capital grants, prudently using capital receipts and utilising borrowing and other financing options as detailed in Treasury Management Practice 4. In addition, the possibility of debt re-scheduling will be kept under review.

The Authority has assumed an average borrowing rate for new borrowing of 4.6% in the Treasury Management Strategy for 2009/10.

4.0 PRUDENTIAL INDICATORS FOR TREASURY MANAGEMENT

- 4.1 The purpose of these Prudential Indicators is to contain the activity of the treasury management function within certain limits, reducing the risk or likelihood of an adverse movement in interest rates or borrowing decisions impacting negatively on the Authority's overall financial position.

PRUDENTIAL INDICATORS FOR TREASURY MANAGEMENT	2008/09	2009/10	2010/11	2011/12
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The Authorised Limit for External Debt and Operational Boundary separately identify borrowing from other Long Term Liabilities such as finance leases. The Operational Boundary is based on the estimate of most likely, prudent but not worst case scenario and represents a key management tool for in year monitoring. The Authorised Limit includes additional headroom to allow for unusual cash movements.

Upper limits for fixed interest rate exposures have been set for 2009/10, 2010/11 and 2011/12 at 100% of outstanding principal sums.

Upper limits for variable interest rate exposures have been set for 2009/10, 2010/11 and 2011/12 at 35% of outstanding principal sums.

This means that the Treasurer will manage fixed interest rate exposures between 100% and 65% and variable rate exposures between 35% and 0% in 2009/10.

There are no proposals for the Authority to invest sums for periods longer than 364 days.

The amount of projected borrowing that is fixed rate, maturing in each period as a percentage of total projected fixed rate borrowing is:

Maturity structure of fixed rate borrowing	upper limit	lower limit
under 12 months	20%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	20%	0%
5 years and within 10 years	20%	0%
10 years and above	90%	20%

5.0 ANNUAL INVESTMENT STRATEGY

5.1 This Authority has regard to the Welsh Assembly Government’s Guidance on Local Government Investments and CIPFA’s Treasury Management in Public Services:Code of Practice and Cross Sectoral Guidance Notes (“CIPFA TM Code”).

5.2 This Annual Investment Strategy states in paragraph 5.8.1 which investments the Authority may use for the prudent management of its treasury balances during the financial year.

5.3 This Strategy also sets out:

- The maximum periods for which funds may be prudently committed in each asset class;

- The amount to be invested in each asset class;
- The investment instruments to be used by the Authority's in-house officers;
- The minimum amount to be held in short-term investments (i.e. to be repaid or redeemed within 12 months of making the Investment).

5.4 Investment Objectives

5.4.1 All investments will be in sterling. The general policy objective for this Authority is the prudent investment of its treasury balances. The investment priorities are the:

- (a) **security** of capital; and
- (b) **liquidity** of investments.

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

5.4.2 The Welsh Assembly Government maintains that the borrowing of monies purely to invest or on-lend and make a return is unlawful and this Authority will not engage in such activity.

5.5 Security of Capital : The use of Credit Ratings

5.5 .1 This Authority relies on credit ratings published by Fitch Ratings, Moody's Investors Service or Standard & Poor's to establish the credit quality of counterparties and investment schemes. The Authority has also determined the minimum long-term and short-term and other credit ratings it deems to be "high" for each category of investment .

5.5.2 Monitoring of credit ratings:

- All credit ratings are monitored by our treasury management advisors who will inform us on a daily basis of relevant changes.
- If a counterparty's or investment scheme's rating is downgraded with the result that it no longer meets the Authority's minimum criteria, the further use of that counterparty/investment scheme as a new investment will be withdrawn immediately.

- If a counterparty is upgraded so that it fulfils the Authority's criteria, it will be included in the Counterparty List.

5.6 Investment balances/Liquidity of investments

5.6.1 Based on its cash flow forecasts, the Authority anticipates its fund balances in 2009/10 to range between £26m and £32m.

5.6.2 The minimum amount of its overall investments that the Authority will hold in short-term investments is 50%.

5.6.3 Giving due consideration to the Authority's level of balances over the next 3 years, the need for liquidity, its spending commitments and provisioning for contingencies, it is considered that no fund balances can be prudently committed to longer term investments (i.e. those with a maturity exceeding a year). However, this strategy will be kept under review and any suggested amendment to this strategy will be reported to the Authority.

5.7 Provisions for Credit-related losses

5.7.1 If any of the Authority's investments appear at risk of loss due to default (i.e. this a credit-related loss, and not one resulting from a fall in price due to movements in interest rates) the Authority will make revenue provision of an appropriate amount.

5.8 Investment Strategy to be followed in-house

5.8.1 Investment is restricted to Specified Investments (those which offer high security and liquidity, are in sterling and have a maturity of less than 1 year) as follows:

- U.K. Local Authorities, parish councils and community councils
- Supranational Institutions
- UK Government Debt Management Office
- Money Market Funds
- Banks
- Building Societies
- Business Reserve Accounts

5.8.2 With the exception of the UK Government Debt Management Office, the total investment in any single institution, bank or group of banks is limited to £3m at any one time. All deposits in the Debt Management Account are guaranteed by HM Government and therefore have the equivalent of a sovereign triple A credit rating. In view of the security guarantee associated with investments in the DMA it is recommended that for this particular counterparty the £3 million limit on investments is not required.

5.8.2 This policy further restricts the above by limiting the bodies approved to those with “high credit rating”. “High” is defined as:

- AAA rating for Money Market Funds
- Long term rating of A- and/or short term rating of F1/A1/P1 for specified investments in banks and building societies or, in the case of building societies, those with assets in excess of £1bn.
- Individual / Financial Strength – C (Fitch / Moody’s only)
- Support – 3 (Fitch)

Recognising that credit ratings can vary across the three ratings’ agencies, investments will only be placed with a particular institution provided the lowest rating meets the minimum standard.

5.8.3 In addition, the Authority will use banks whose ratings fall below the criteria specified above if all of the following conditions are met:

- (i) wholesale deposits in the bank are covered by a government guarantee;
- (ii) the government providing the guarantee is rated “AAA” by all three major rating agencies; and
- (iii) the Authority’s investments with the bank are limited to amounts and maturities within the terms of the stipulated guarantee.

5.8.4 Banks and building societies eligible for HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008 are also approved for deposits.

5.8.5 The Authority’s own banker is also approved if its ratings falls below the minimum on the understanding that deposits will be left with the bank for no longer than necessary.

5.8.6 The Authority does not employ external fund managers to manage the day to day Treasury Management activities.

5.9 End of year Investment Report

5.9.1 At the end of the financial year, the Authority will prepare a report on its investment activity as part of its Annual Treasury Report.

6 PERFORMANCE INDICATORS

6.1 The Treasury Management Code of Practice requires the Authority 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. The indicators the Authority will use to assess its performance are:

- Debt - average rate of borrowing achieved compared to the UK average
- Investments – internal returns compared to base rate

6.2 The results of these indicators will be reported in the Annual Treasury Report.

7.0 DELEGATED POWERS

7.1 Authority

The setting of borrowing limits, Prudential Indicators and Treasury Management Strategy requires the resolution of the full Authority.

7.2 Treasurer

The Treasurer's responsibilities for treasury management are detailed in the Authority's Financial Standing Orders and Financial Regulations and in the Authority's Scheme of delegated Powers.

In practice most of the work is carried out by members of the Finance Division. A summary of the roles of the staff concerned is contained in Treasury Management Practice 5.

8.0 REVIEW AND REPORTING ARRANGEMENTS

- 8.1 An annual report will be made by the 30th September in the following financial year for presentation to the Authority. Monitoring reports will be prepared monthly by the Principal Financial Accountant for review by the Treasurer.