Agenda Item No. 6

Note:

It is important to note that the Treasury Strategy Statement is adopted by the Council, based upon advice from its external Treasury advisors, and accordingly the Strategy is tailored to meet the specific and unique needs of the Council. All financial information contained within this Report and Statement should not be used by any individual or organisation as a basis for making investment or borrowing decisions. The Council and its Treasury advisors will not accept any liability on behalf of any individual or organisation that seeks to act on the financial information contained within this Report and Statement.

Audit Committee – 9th February 2012

Report of the Treasurer

Treasury Management

Purpose of Report

1. The purpose of this report is:

   - to outline treasury activity in the year 2011/12 up to the end of December;
   - to seek approval of the Treasury Strategy Statement 2012/13;
   - to seek approval of an amendment to the Council's Treasury Policy Statement.

Background

2. The Council undertakes treasury management activity on its own behalf and as administering authority for the West Midlands Debt Administration Fund *(WMDAF)*. We are responsible for administering capital funding of £483m on our own account and another £201m on behalf of the WMDAF. Dudley's capital funding is expected to increase by £338m on 28th March 2012 as a result of the implementation of Self Financing for the Housing Revenue Account (HRA). The treasury function is governed by the Council's Treasury Policy Statement and Treasury Management Practices.

3. Our borrowing and investment activities in the current year have been undertaken in the context of historically low interest rates. The Bank Rate has remained at 0.5% since March 2009 and is considered likely to stay at that level to at least the end of 2012/13.

Treasury Activity 2011/12 - Dudley fund

4. Treasury activities in the current year have been undertaken in the context of the Treasury Strategy Statement 2011/12 approved by Audit Committee and Full Council in February 2011. In that document we anticipated that long term borrowing would be required in the next 12 months.

5. Our investments up to the middle of January have averaged around £52.2 million (with significant day to day variation as a result of cash flow). The average return on these investments was 0.71%. All investments were placed with institutions that satisfied the criteria for credit-worthiness set out in the Treasury Strategy Statement 2011/12. The performance of our investments is largely dependent on movements in short-term (up to one year) rates. The average 7-day LIBID[1] for the financial year to the end December has been 0.49%. Our investment activity for 2011/12 (to date) is set out in more detail in **Appendix 1**.

6. The returns outlined above have been achieved without compromising on the security of the Council's investments. We have maintained and continue to maintain an approved investment list that sets the highest rating standards. We have an account with the Government's Debt Management Office which provides maximum security but low returns. We are only using this account where we cannot place funds with a bank that meets our strict criteria. The majority of short-term investments are now in variable rate call accounts with approved counterparties, which offer a relatively good rate of return compared to fixed term deposit accounts as well as higher liquidity.

7. The average value of long-term borrowings up to the end of December 2011 has been £209 million. The average rate of interest on these borrowings was 5.4% and they were due to mature on dates ranging from the current year to 2057.

8. The rate for a 50-year loan from the Public Works Loan Board (PWLB) has fluctuated during 2011-12 from 3.98% to 5.25% and was standing at 4.12% in early January.

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9. It has not as yet been necessary to undertake any new long-term borrowing due to favourable cash flow, but we are monitoring interest rates and cash flow closely. It is less likely that long-term borrowing will be required in the next few months (except for HRA Self Financing).

10. It has not been necessary to undertake any short-term borrowing in the current year to date. Daily cash flow has been managed through the use of call accounts.

[1] 7-day LIBID is a measure of the average return from a 7-day investment on the London money market.

Treasury activity 2011/12 - WMDAF

11. Having consulted with our advisors at Arlingclose, we did not identify any opportunities to improve our position by restructuring of debt. The latest estimate of interest payable by members of the WMDAF in 2011/12 is 6.6%.

Treasury Strategy Statement 2012/13

12. The Treasury Strategy Statement covers our latest capital funding requirements, our view of interest rate movements and our strategy for borrowing and investment in the light of that view. As such, it needs to be reviewed annually. The proposed Treasury Strategy Statement for 2012/13 is attached as **Appendix 2**.

13. Our expectations for interest rates over the next twelve months, which will be subject to continuous review with our treasury advisors, are as follows (PWLB rates are generally 0.8% to 1% above Government gilts):

- **Short-term rates.** The Bank Rate will remain at 0.5% through 2012/13 and probably until the end of 2014/15.
- **Long-term rates.** The 20-year PWLB rate will rise in 2012/13 from 4.05% to 4.25%.
- **Very long-term rates**. The 50-year PWLB rate will rise in 2012/13 from 4.40% to around 4.8%.

14. The Local Government Act 2003 introduced a system of “prudential borrowing” allowing councils to set their own borrowing limits subject to criteria of prudence and affordability. These criteria are set out in more detail in the Chartered Institute of Public Finance & Accountancy (CIPFA) Prudential Code which specifically requires us to set a number of prudential indicators. The proposed indicators that relate to treasury management are set out in the Treasury Strategy Statement.

15. Councils’ investment activities are regulated by government guidance issued under Section 15(1)(a) of the Local Government Act 2003. Section 5 of the Treasury Strategy Statement constitutes an “Annual Investment Strategy” produced in accordance with the government guidance and revised CIPFA Code of Practice on Treasury Management in the Public Services 2011.

16. In order to protect the Council’s position if an individual or organisation were to act upon the views expressed in this report, we have deemed it necessary to produce a disclaimer which is shown as a note at the head of the report and Appendix 2.

Self Financing of the Housing Revenue Account

17. Reforms to Council Housing implemented in the Localism Act 2011 involve removal of the housing subsidy system and its replacement with a one-off reallocation of debt. The settlement of the reallocation is expected to take place on 28th March 2012 and will result in the Council having an increase in debt to fund the settlement of £338.1m. Further details are available in the Housing Revenue Account report to Cabinet on 8th February 2012.

18. In previous years and in the current year, the allocation of debt financing costs between the HRA and the General Fund has been by means of a statutory calculation. For 2012/13 onwards, the Council will need to determine the method of allocation of these costs as part of its Treasury Management Strategy. The proposed method of debt allocation is detailed in Appendix 2. It is in accordance with guidance from the Chartered Institute of Public Finance and Accountancy (CIPFA). It seeks to allocate the costs of existing debt equitably between the HRA and the General Fund while ensuring that rates of interest achieved on the new housing debt are reflected in the HRA.

19. Revisions are proposed to the Prudential Indicators for 2011/12 in the Treasury Strategy Statement to reflect the increase in borrowing at the end of the year in relation to the Self Financing settlement

Treasury Policy Statement

20. The CIPFA Code of Practice on Treasury Management in the Public Services 2011 requires the Council to amend its Treasury Policy Statement by the addition of wording highlighted in **Appendix 3.**

Finance

21. Forecasts of performance against budget for treasury management activities are highly sensitive to movements in cash flow and interest rates. Budgets were amended in October to reflect a surplus of £2.0m compared to the original budget for 2011/12. This surplus was mainly due to variations in cash flow. Current prudent forecasts indicate a further surplus of £1.2m against the revised budget.

Law

22. These matters are governed by Part IV of the Local Government and Housing Act 1989 and Section 111 of the Local Government Act 1972, which empowers the Council to do anything which is calculated to facilitate or is conducive or incidental to the discharge of its various statutory functions.

Equality Impact

23. The treasury management activities considered in this report have no direct impact on issues of equality.

Recommendation

24. That the Committee:

- notes the treasury activities in 2011/12 outlined in this report;
- approves the Treasury Strategy 2012/13 attached as Appendix 2;
- authorises the Treasurer to effect such borrowings, repayments and investments as are appropriate and consistent with the approved Treasury Strategy and relevant guidance;
- approves the Treasury Policy Statement attached as Appendix 3
- refers all of the above for approval by full Council at its meeting on 27th February

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Iain Newman
Treasurer

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List of Background Papers

- Treasury Policy Statement, Treasury Management Practices and Schedules to the Treasury Management Practices.
- The Local Government Act 2003
- The Prudential Code for Capital Finance in Local Authorities (CIPFA)
- Guidance on Local Government Investments Issued by the Secretary of State under section 15(1)(a) of the Local Government Act 2003
- Code of Practice for Treasury Management in the Public Services (CIPFA)

Appendix 1

Investment Activity 2011/12 to 9th January 2012

Counterparty name	Number of investments	Average value £ million	Average rate %	Average duration (days)
Barclays Treasury Direct	17	9.0	0.41	14
Debt Management Office	5	1.5	0.25	10
Nationwide Building Society	4	1.3	0.42	3
Bank of Scotland Call account	N/A	7.3	0.75	18
Yorkshire Bank Call Account 1	N/A	1.8	0.75	Call
Yorkshire Bank Call Account 2	N/A	3.0	0.50	Call
Santander Call Account	N/A	11.8	0.80	Call
Nat West Call Account	N/A	9.5	0.80	Call
HSBC Call Account	N/A	6.5	0.32	Call
Salford City Council	1	0.5	11.25	Matures in 2020

The table above includes investments that commenced during 2010/11 and were due to mature in the current financial year.

Appendix 2

Note:

It is important to note that the Treasury Strategy Statement is adopted by the Council, based on advice from its external Treasury advisors, and accordingly the Strategy is tailored to meet the specific and unique needs of the Council. All financial information contained within this Report and Statement should not be used by any individual or organisation as a basis for making investment or borrowing decisions. The Council and its Treasury advisors will not accept any liability on behalf of any individual or organisation that seeks to act on the financial information contained within this Report and Statement.

DUDLEY METROPOLITAN BOROUGH COUNCIL
TREASURY STRATEGY STATEMENT 2012/13

1.0 Introduction

1.1 This Treasury Strategy Statement details the expected activities of the treasury function in the financial year 2012/13. The suggested strategy is based upon officers' views of interest rates as advised by external advisors, supplemented with leading market forecasts. It should be noted that the use of expert external advisors does not remove the responsibility of Members and officers for treasury management functions and that those functions cannot be delegated to any outside organisation. The strategy covers:

- the current portfolio position
- prudential and treasury indicators
- prospects for interest rates
- temporary investment strategy
- requirements and strategy for long-term borrowing
- debt rescheduling and premature repayment opportunities
- treasury implications of HRA Self Financing

2.0 Current Portfolio Position

2.1 The Council's estimated debt position (excluding HRA Self Financing debt) as at 1st April 2012 is as follows:

	£m
Long-term debt:	
- PWLB fixed rate	191.9
- Market fixed rate	6.8
- Market LOBO[2]	10.0
Short-term debt	0.2
Total debt	208.9

2.2 The average rate of interest on the above debt is expected to be 5.3%.

[2] Lenders Option Borrowers Option (LOBO). This loan was at a fixed rate of 4.6% until February 2009 after which the rate may be varied at the lender's option. If the lender exercises this option to vary the rate then we, as the borrower, have the option to repay the loan.

2.3 The Council is expected to take on £338.1 million of debt for HRA Self Financing on 28th March 2012. The Government has announced that special PWLB loans will be available for HRA Self Financing at rates of about 0.1% above gilts compared to PWLB rates generally available to local authorities which are at up to 1% above gilts. If government gilt yields remain around their current level then on 28th March this will equate to an average interest rate of between 3% and 3.5% for HRA Self Financing loans. This will reduce the average interest rate on Dudley borrowing to around 4.0%

2.4 The average level of investments held by the Council during 2011/12 to early January 2012 was £52.2m. Cash flow monitoring indicates that long term borrowing may be required in the next 12 months.

2.5 The Council also administers the debt of the former West Midlands County Council on behalf of the West Midlands districts . The estimated debt position at 1st April 2012 is as follows:

	£m
Long-term debt:	
- PWLB fixed rate	184.1
- Market fixed rate	6.8
- Market LOBO[3]	10.0
Short-term debt	0
Total debt	200.9

2.6 The average rate of interest charged to the West Midlands fund is expected to be 6.6%.

3.0 Prudential & Treasury Indicators

3.1 Under the Local Government Act 2003 and the Prudential Code for Capital Finance in Local Authorities, local authority capital spending and its borrowing to fund that spending is limited by what is affordable, prudent and sustainable. The Prudential Code sets out a number of indicators that enable the authority to assess affordability and prudence. The following indicators are relevant for the purposes of setting an integrated treasury management strategy.

3.2 <u>Treasury Indicators in the Prudential Code</u>

3.3 The Prudential Code requires that the total external debt does not exceed the Authorised Limit for external debt and only exceeds the Operational Boundary for external debt temporarily on occasions due to variation in cash flow.

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[3] Lenders Option Borrowers Option (LOBO). This loan was at a fixed rate of 4.6% until February 2007 after which the rate may be varied at the lender's option. If the lender exercises this option to vary the rate then we, as the borrower, have the option to repay the loan.

These external debt indicators are intended to ensure that levels of external borrowing are affordable, prudent and sustainable. The authorised limit for external debt is a statutory limit (section 3 of the Local Government Act 2003) that should not be breached under any circumstances. It has been calculated to take account of the Council's capital expenditure and financing plans and allowing for the possibility of unusual cash movements. The operational boundary for external debt has also been calculated with regard to the Council's capital expenditure and financing plans allowing for the most likely, prudent, but not worst case scenario for cash flow. Temporary breaches of the operational boundary, due to variations in cash flow, will not be regarded as significant. Actual external debt represents the closing balance for borrowing and other long-term liabilities.

The indicators have been updated to reflect the increased borrowing requirement as a result of the implementation of Housing Self Financing.

	2010/11	**2011/12**	**2012/13 Revised**	**2013/14 Revised**	**2014/15**
	£m	**£m**	**£m**	**£m**	**£m**
Authorised limit for external debt:					
Borrowing	n/a	991	993	974	958
Other long term liabilities	n/a	46	50	52	55
Total	**n/a**	**1037**	**1043**	**1026**	**1013**
Operational boundary:					
Borrowing	n/a	790	842	845	833
Other long term liabilities	n/a	46	50	52	55
Total	**n/a**	**836**	**892**	**897**	**888**
Actual External Debt:					
Borrowing	419.4	n/a	n/a	n/a	n/a
Other long term liabilities	42.9	n/a	n/a	n/a	n/a
Total	**462.3**	**n/a**	**n/a**	**n/a**	**n/a**

3.4 Treasury Indicators in the Treasury Management Code

CIPFA Code of Practice for Treasury Management in the Public Services

The Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Services.

Interest rate exposures

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The upper limit for fixed interest reflects the fact that it is possible to construct a prudent treasury strategy on the basis of using only fixed rate debt and investments, so long as the maturity dates of these debts and investments are reasonably spread. The same does not apply to variable rates where a 100% exposure could lead to significant year on year fluctuations in the cost of debt. The upper limit for variable rate exposure allows for the use of variable rate debt to offset our exposure to changes in short-term rates on our portfolio of investments. This limit reduces over time as our strategy is to gradually reduce our level of investments.

	2011/12	**2012/13**	**2013/14**	**2014/15**
Upper limit for fixed interest rate exposure	100	100	100	100
Upper limit for variable rate exposure	10	10	10	10

Maturity structure of borrowing and investments

The maturity structure of fixed rate borrowing is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

	Upper limit %	**Lower limit %**
under 12 months	10	0
12 months and within 24 months	10	0
24 months and within 5 years	15	0
5 years and within 10 years	25	0
10 years and above	100	40

Upper Limit for total principal sums invested over 364 days

The purpose of the limits for principal sums invested for periods longer than 364 days is to contain the Council's exposure to the possibility of loss that might arise as a result of having to seek early repayment of principal sums invested. On the basis of prudent treasury management the proposed upper limit on principal maturing in any one year for sums invested for over 364 days is £10m.

Gross and Net Debt

This is a new indicator that CIPFA has added to the 2011 Treasury Management Code. The purpose of this indicator is to highlight a situation where the Council is planning to borrow in advance of need. CIPFA has acknowledged that the upper limit does not work as was intended and is working on a revised indicator. This indicator will be amended once revised guidance has been received from CIPFA.

	2011/12	2012/13	2013/14	2014/15
	%	%	%	%
Upper limit of Net Debt as a percentage of Gross Debt	100	100	100	100

4.0 Prospects for Interest Rates

4.1 The Council has appointed Arlingclose as its treasury advisor and has made use of their services in formulating a view on interest rates.

4.2 We have arrived at the following view of the prospects for interest rates over the next twelve months (PWLB rates are generally 0.8% to1% above Government gilts):

- **Short-term rates.**The Bank Rate will remain at 0.5% through 2012/13.
- **Long-term rates.** The 20-year rate for PWLB maturity loans will rise in 2012/13 from 4.05% to 4.25%.
- **Very long-term rates**. The 50-year rate for PWLB maturity loans will rise in 2012/13 from 4.40% to around 4.80%.

5.0 Economic Background

- The UK's status as a safe haven remains for now and keeps Gilt yields suppressed.
- Conventional monetary policy has become largely redundant; the Bank of England and the US Federal Reserve have signalled their respective official interest rates will be on hold through to the end of 2012. We think that it could be 2016 before official interest rates rise.
- The Bank of England's Monetary Policy Committee (MPC) has returned to unconventional monetary policy and embarked on a further round of Quantitative Easing (QE).

Underlying Assumptions:

- Stress in financial markets has continued to build. Rates within Interbank markets (where banks fund the majority of their day to day operations) continue to climb. This dynamic was a feature of the banking crisis that occurred in 2008 and whilst the authorities have flooded the markets with liquidity still provides a key barometer of rising risk within markets.
- The MPC's decision to embark on a further £75 billion of QE – which the Minutes showed was unanimously supported – is likely to be expanded in

the coming months as some members of the MPC had voted for £100bn of QE.

- Inflation has moderated back to 4.8% from what is considered to be its peak of 5.2% reached in October. The Bank of England expects domestic inflation to subside markedly in 2012 as the twin effects of the VAT increase and surge in oil prices fall out of the twelve month series.
- Economic growth meanwhile remains largely illusive not helped by the considerable uncertainty and expansion of risks presented by the crisis in the Eurozone. Even if a credible and effective policy is implemented, the scale of the problems means that there is likely to be a prolonged period of subdued growth within the euro area. A failure to meet the challenges would almost certainly have significant implications for the global economy.
- Recent data and surveys suggest that the UK economy has lost the admittedly fragile momentum since the summer. Business and consumer surveys point to continued weakness in coming months and the situation in the euro area is likely to further undermine confidence and lead to tighter credit conditions for households and firms.
- Against this uncertain backdrop the ability of the economy (government, companies and individual consumers) to accommodate an increase in the cost of money through higher interest rates – in the absence of a deterioration in the high credit standing that the UK enjoys – remains unlikely.

Our overall strategy will be based on the projections above. However, we will maintain flexibility to take account of unexpected variations from our forecast.

6.0 Annual Investment Strategy

6.1 Our investment activities are subject to government guidance issued under Section 15(1) (a) of the Local Government Act 2003. This section of the Treasury Strategy Statement constitutes an “Annual Investment Strategy” produced in accordance with the guidance.

6.2 In accordance with Investment Guidance issued by the Department of Communities and Local Government (DCLG) and best practice the Council’s primary objective in relation to the investment of public funds remains the security of capital. The liquidity or accessibility of the Council’s investments followed by the yields earned on investments is important but are secondary considerations.

6.3 Credit markets remain in a state of distress as a result of the excessive and poor performing debt within the financial markets. In some countries the extent and implications of national debt built up have lead to a sovereign debt crisis and a banking crisis, with the outcome still largely unknown. It is against this backdrop of uncertainty that the Council’s investment strategy is framed.

6.4 *Strategy for “specified investments”*

6.4.1 The Council will make use of specified investments (as defined within the terms of the government guidance). These are investments that satisfy the following conditions:

a) The investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling.
b) The Council may require that the investment be repaid or redeemed within 12 months of the date on which the investment was made.
c) The making of the investment is not defined as capital expenditure by virtue of regulation 25(1)(d) of the Local Authorities (Capital Finance and Accounting)(England) Regulations 2003.
d) The investment satisfies *either* of the following conditions:

    I. The investment is made with the UK government, a local authority, a parish council or a community council. or
    II. The investment is made with a body or in an investment scheme of high credit quality

6.4.2 For the purpose of this strategy a body or investment scheme is deemed to be of high credit quality if it has minimum short-term ratings of F1 (Fitch), P1 (Moody's), and A1 (Standard and Poors), and a support rating of 1 from Fitch.

6.4.3 As well as credit ratings the Council and its advisors (Arlingclose Ltd) analyse and constantly monitor the following factors in determining high credit quality when selecting countries and financial institutions for suitable investment :

- Credit Default Swaps (where quoted)
- Economic fundamentals (for example Net Debt as a percentage of GDP)
- Sovereign support mechanisms
- Share Prices
- Corporate developments, news, articles, markets sentiment and momentum
- Subjective overlay – or, put more simply, common sense

6.4.4 Due to the current period of stress in financial markets, the Council's investments must also satisfy all the following more stringent conditions:

- The Council will not invest in non-UK institutions

- Investments of a maximum duration of 3 months are permitted with UK institutions which have the highest short term credit rating from all three main credit rating agencies

- Investments of a maximum duration of 1 month are permitted with UK institutions which meet the criteria of 6.4.2 above but do not have the highest short term credit rating from all three main credit rating agencies

6.4.5 If conditions in the financial markets worsen during 2012-13 or other factors indicate that increased security of Council funds is required, the Treasurer may impose tighter restrictions on the type of investments and institutions used by the Council, than those detailed in this strategy.

6.4.6 The Council banks with HSBC. At the current time, it does meet the minimum credit criteria and has the highest credit rating for a UK bank. Even if the credit rating falls below the Council's minimum criteria HSBC will continue to be used for short term liquidity requirements (overnight and weekend investments) and business continuity arrangements.

6.5 *Strategy for "non-specified investments"*

6.5.1 Non-specified investments are those that do not meet the criteria in 6.4.1 above.

6.5.2 In determining which categories of non-specified investments may prudently be used, we will take account of:

- Advice from our treasury management consultants at Arlingclose.
- The views of experts at other councils.
- To the extent that investments are for a duration of 12 months or more, long-term credit ratings as determined by Fitch.

6.5.3 Due to the current period of stress in financial markets, the Council will not place its funds in non-specified investments.

6.6 *Liquidity of investments*

6.6.1 In determining the maximum period for which investments may be held, we will have regard to our most recent cash-flow forecast. We will not enter into an investment where our cash-flow forecast indicates that, as a result of that investment, we would be forced to borrow money in a future year that we would not otherwise have had to borrow.

6.6.2 We will ensure that, at the time of making a new investment, long-term investments (investments of one year's duration or more) constitute no more than 50% of our total pool of investments.

6.7 *Limit on investments with a single institution*

6.7.1 Investments with a single institution or group of banks should not exceed 20% of our total pool of investments or £5million (whichever is greater).

6.8 *Policy on the use of external service providers*

The Council uses Arlingclose Ltd as its external treasury management advisers. 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.

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.

7.0 The Use of Financial Instruments for the Management of Risks

7.1 Currently, Local Authorities' legal power to use derivative instruments remains unclear. The General Power of Competence enshrined in the Localism Bill is not sufficiently explicit. Consequently, the Council does not intend to use derivatives. Should this position change, the Council may seek to develop a detailed and robust risk management framework governing the use of derivatives, but no change in strategy will be made without full Council approval.

8.0 Requirements and Strategy for Long-Term Borrowing

8.1 The primary factor in determining whether we undertake new long-term borrowing will be cash flow need. Due to the current period of stress in financial markets, we will seek to minimise the time between borrowing and anticipated cash flow need, subject to the need to maintain day to day liquidity.

8.2 Our interest rate expectations (outlined in 4.2) provide a variety of options:

- that short-term variable rates will be good value compared to long-term rates, and are likely to remain so for potentially at least the next couple of years. Best value will therefore be achieved by borrowing short term at variable rates in order to minimise borrowing costs in the short term.

- that the risks intrinsic in the shorter term variable rates are such, when compared to historically relatively low long term fixed funding, which may be achievable in 2012/13, that the Council will maintain a stable, longer term portfolio by drawing longer term fixed rate funding at a marginally higher rate than short term rates.

8.3 Against this background caution will be adopted with the 2012/13 treasury operations. The Treasurer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances.

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

- If it were felt that there was a significant risk of a sharp rise in long and short term rates, perhaps arising from a greater than expected increase in world economic activity, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still relatively cheap

- If it were felt that there was a significant risk of a sharp fall in long and short term rates, due to growth rates remaining low or weakening, then long term borrowings will be postponed

8.4 With respect to the West Midlands Debt, variances due to timing differences between the maturity profile of the debt and repayments from authorities can be managed by short term borrowing in 2012-13. As a result, we do not anticipate that further long-term borrowing will be needed during 2012/13. We shall take out long term borrowing on West Midlands debt when it is economically advantageous to do so.

9.0 Debt Rescheduling and Premature Repayment Opportunities

9.1 We may consider rescheduling or premature repayment with the following aims:

- the generation of cash savings at minimum risk;
- in order to help fulfil the strategy outlined in 8 above;
- in order to enhance the balance of the long-term portfolio *(by amending the maturity profile and/or the balance of volatility).*

9.2 Any rescheduling or premature repayment will be reported to an appropriate committee at the meeting following its implementation.

10.0 HRA Self Financing

10.1 In previous years and in the current year, the allocation of debt financing costs between the HRA and the General Fund has been by means of a statutory calculation. For 2012/13 onwards, the Council is required to determine the method of allocation of these costs as part of this Treasury Management Strategy. The methodology set out below seeks to allocate the costs of existing debt equitably between the HRA and the General Fund while ensuring that rates of interest achieved on the Self Financing housing debt are reflected in the HRA.

10.2 The CIPFA Treasury Management Code of Practice lays out the key principles of debt allocation to be as follows :

- The underlying principle for the splitting of loans, at transition, must be that of no detriment to the General Fund.
- Local authorities are required to deliver a solution that is broadly equitable between the HRA and the General Fund.
- Future charges to the HRA in relation to borrowing are not influenced by General Fund decisions, giving a greater degree of independence, certainty and control.
- Un-invested balance sheet resources which allow borrowing to be below the Capital Financing Requirement (CFR) are properly identified between General Fund and HRA.

The Council has adopted these principles as well as the principle that borrowing charges to the HRA are not influenced by treasury activity of the West Midlands Debt Administration Fund.

10.2 For reasons of clarity and transparency the Council has decided to implement a ”two-pool” approach with separate debt pools for the Housing Revenue Account and General Fund, as detailed below :

- Existing Dudley MBC loans will be notionally split between the HRA and General Fund so that the existing HRA CFR is fully funded by external borrowing at 1 April 2012.

- The whole of the new borrowing due to be taken for HRA Self Financing will be allocated to the HRA pool.

- Future treasury management decisions on the structure and timing of new borrowing will be made independently for the HRA and General Fund (including any replacement of the notionally split loans)

- Interest on loans will be calculated in accordance with proper accounting practices (i.e. interest on external borrowing attributed to HRA loans being attributed to the HRA and similarly for the General Fund)

10.3 In the case of the HRA/General Fund being in a position to reduce the CFR to a level lower than the principal outstanding on their external borrowing, loans will be transferred between the pools and a notional premium or discount recognised. If the Council wishes to swap loans between the HRA and the General Fund as a result of strategic decisions and suitability of their relevant debt structures, this would also be undertaken with the recognition of a notional premium or discount.

10.4 Where the HRA or General Fund have surplus cash balances which allow either account to have external borrowing below its level of CFR (internal borrowing), the rate charged on the internal borrowing will be based on the average rate of interest earned on cash balances for the financial year.

10.5 Settlement will take place on 28th March 2012; however, CFR and debt figures will not be finalised until the accounts are closed. As a result of this difference in timing:

- Budgets and treasury management strategies will be compiled based on estimates.
- Any new borrowing from 1st April 2012 will be allocated either to the General Fund or the HRA as appropriate depending on the purpose for which it has been borrowed.
- Pre-settlement loans will be frozen at 31st March 2012 and notionally split as soon as final figures are known.

10.6 Any future changes to the method of allocating debt financing costs between the HRA and General Fund would require amendments to the Treasury Strategy Statement and approval by Council.

Appendix 3

Treasury Policy Statement

1. The Council defines its treasury management activities as:

   - the management of its 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.

2. 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 their risk implications for the Council, **and any financial instruments entered into to manage these risks.**

3. 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 principles of achieving best value in treasury management, and to employing suitable performance measurement techniques within the context of effective risk management.