

## Treasury Management Strategy Statement and Investment Strategy 2012/13 to 2014/15

### 1 Summary

- 1.1 The Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Treasury Management Code) and the Prudential Code require local authorities to determine the Treasury Management Strategy Statement (TMSS) and Prudential Indicators on an annual basis. The TMSS also includes the Annual Investment Strategy (AIS) that is a requirement of the Department for Communities and Local Government's Investment Guidance.
- 1.2 Treasury Management is about the management of risk. The Council is responsible for its treasury decisions and activity. No treasury management activity is without risk.
- 1.3 As per the requirements of the Prudential Code, the Council approved the adoption of the CIPFA Treasury Management Code at its meeting on 18 February 2010.
- 1.4 All treasury activity will comply with relevant statute, guidance and accounting standards.
- 1.5 The prudential indicators which are all covered in Annex B are:
  - net borrowing and the Capital Financing Requirement
  - estimates of capital expenditure and capital financing
  - ratio of financing costs to net revenue stream
  - Capital Financing Requirement
  - actual external debt
  - incremental impact of capital investment decisions
  - authorised limit and operational boundary for external debt
  - adoption of the CIPFA Treasury Management Code
  - gross and net debt

- upper limits for fixed interest rate exposure and variable interest rate exposure
- maturity structure of fixed rate borrowing
- credit risk
- upper limit for total principal sums invested over 364 days.

1.6 A glossary of terms is provided in Annex E.

**1.7 This Appendix recommends to the County Council that:**

- **The Treasury Management Strategy Statement and Investment Strategy for 2012/13, although this would also be adopted for the rest of 2011/12, be approved.**
- **The Prudential Indicators for 2012/13, 2013/14 and 2014/15 be approved – Annex B.**
- **The Minimum Revenue Provision (MRP) Statement be approved – Section 10.**

## 2 Capital Financing Requirement

- 2.1 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). The CFR, together with Usable Reserves, are the core drivers of the Council's Treasury Management activities.
- 2.2 The Council's current level of debt and investments is set out at Annex A.
- 2.3 The Council is able to borrow funds in excess of the current level of its CFR up to the projected level in 2014/15. The Council is likely to only borrow in advance of need if it considers that the benefits of borrowing at interest rates now compared to where they are expected to be in the future, outweighs the current cost and risks associated with investing the proceeds until the borrowing is actually required.
- 2.4 The forecasted movement in the CFR in coming years is one of the Prudential Indicators (PIs). The movement in actual external debt and usable reserves combine to identify the Council's borrowing requirement and potential investment strategy in the current and future years.

**Table 1: Balance Sheet Summary Analysis**

	<b>31/03/2012 Estimate £m</b>	<b>31/03/2013 Estimate £m</b>	<b>31/03/2014 Estimate £m</b>	<b>31/03/2015 Estimate £m</b>
<b>Total Capital Financing Requirement</b>	715.9	735.2	786.4	804.1
<b>Less:</b>				
Existing Profile of Borrowing	-387.7	-379.1	-368.6	-354.1
Other Long Term Liabilities	-114.7	-138.7	-163.5	-183.3
<b>Cumulative Maximum External Borrowing Requirement</b>	<b>213.5</b>	<b>217.4</b>	<b>254.3</b>	<b>266.7</b>

- 2.5 Table 1 shows that the capital expenditure plans of the Council are currently not being wholly funded from external borrowing sources, as the Council's internal balances and reserves are being used to avoid the need for further external borrowing.

### **3 Interest Rate Forecast**

- 3.1 The economic and interest rate forecast provided by the Council's treasury management adviser, Arlingclose Ltd, is attached at Annex C. The Council will reappraise its strategies from time to time in response to evolving economic, political and financial events.

### **4 Borrowing Strategy**

- 4.1 Treasury management and borrowing strategies in particular continue to be influenced not only by the absolute level of borrowing rates but also the relationship between short and long term interest rates. The interest rate forecast provided in Annex C indicates that an acute difference between short and longer term interest rates is expected to continue. This difference creates a "cost of carry" for any new longer term borrowing where the proceeds are temporarily held as investments because of the difference between what is paid on the borrowing and what is earned on the investment. Whilst the cost of carry can be assumed to be a reasonably short-term issue since borrowing is often for longer dated periods (anything up to 50 years) it cannot be ignored against a backdrop of uncertainty and affordability constraints in the Council's wider financial position.
- 4.2 As indicated in Table 1, the Council has a gross borrowing requirement of £217.4m in 2012/13 but has sufficient balances and reserves to avoid the need for significant external borrowing. By essentially lending its own surplus funds to itself, the Council is able to minimise borrowing costs and reduce overall treasury risk by reducing the level of its external investment balances.

### **5 Sources of Borrowing and Portfolio Implications**

- 5.1 In conjunction with advice from its treasury advisor, the Council will keep under review the following borrowing sources:
- Public Works Loan Board (PWLB)
  - local authorities
  - commercial banks
  - European Investment Bank
  - money markets
  - capital markets (stock issues, commercial paper and bills)
  - structured finance
  - leasing.

- 5.2 The cost of carry has resulted in an increased reliance upon shorter dated and variable rate borrowing. This type of borrowing injects volatility into the debt portfolio in terms of interest rate risk but is counterbalanced by its affordability and alignment of borrowing costs with investment returns. The Council's exposure to shorter dated and variable rate borrowing is kept under regular review by reference to the difference or spread between variable rate and longer term borrowing costs. A narrowing in the spread by 0.5% will result in an immediate and formal review of the borrowing strategy to determine whether a degree of exposure to shorter dated and variable rates is maintained or altered.
- 5.3 The Council has £73.0m exposure to LOBO loans (Lender's Option Borrower's Option) of which all of these can be "called" within 2012/13. A LOBO is called when the lender exercises its right to amend the interest rate on the loan at which point the borrower can accept the revised terms or reject them and repay the loan. LOBO loans present a potential refinancing risk to the Council since the decision to call a LOBO is entirely at the lender's discretion, although the likelihood of a lender exercising their right to increase the interest rate on a LOBO loan in the current low interest rate environment is negligible.
- 5.4 Any LOBOs called will be discussed with the treasury advisers prior to acceptance of any revised terms. The default position will be the repayment of the LOBO without penalty, i.e., the revised terms will not be accepted.

## **6 Debt Rescheduling**

- 6.1 The Council's debt portfolio can be restructured by prematurely repaying loans and refinancing them on similar or different terms to achieve a reduction in risk and/or savings in interest costs.
- 6.2 The lower interest rate environment and changes in the rules regarding the premature repayment of PWLB loans has adversely affected the scope to undertake meaningful debt restructuring although occasional opportunities arise. The rationale for undertaking any debt rescheduling would be one or more of the following:
- savings in risk adjusted interest costs
  - rebalancing the interest rate structure of the debt portfolio
  - changing the maturity profile of the debt portfolio.
- 6.3 Borrowing and rescheduling activity will be reported to the Council in the Annual Treasury Management Report and the regular treasury management reports presented to the Council.

## 7 Annual Investment Strategy

- 7.1 In accordance with Investment Guidance issued by the Department for 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 are important but secondary considerations.
- 7.2 Credit markets remain in a state of distress as a result of the excessive and poor performing debt within the financial markets. In some instances, Greece and Italy being the most notable examples, the extent and implications of the debt it has built up have led 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.
- 7.3 Investments are categorised as "Specified" or "Non-Specified" within the investment guidance issued by the DCLG. Specified investments are sterling denominated investments with a maximum maturity of one year. They also meet the "high credit quality" as determined by the Council and are not deemed capital expenditure investments under Statute. Non-specified investments are, effectively, everything else.
- 7.4 The types of investments that will be used by the Council and whether they are specified or non-specified are as follows:

**Table 2: Specified and Non-Specified Investments**

Investment	Specified	Non-Specified
Term deposits with banks and building societies	✓	✓
Term deposits with other UK local authorities	✓	✓
Certificates of deposit with banks and building societies	✓	✓
Gilts	✓	✓
Treasury Bills (T-Bills)	✓	x
Bonds issued by Multilateral Development Banks	✓	✓
Local Authority Bills	✓	x
Commercial Paper	✓	x
Corporate Bonds	✓	✓
AAA rated Money Market Funds	✓	x
Other Money Market and Collective Investment Schemes	✓	✓
Debt Management Account Deposit Facility	✓	x

- 7.5 A number of changes have been implemented to the investment strategy for 2012/13 in response to changes in the DCLG Guidance and evolving conditions in financial markets. This results in the inclusion of corporate bonds which the DCLG have indicated will become an eligible non-capital investment from 1 April 2012. However, the principal amendments are in relation to the individual institutions with which the Council is prepared to lend its funds.
- 7.6 The Council and its advisors, Arlingclose Ltd, select countries and financial institutions after analysis and ongoing monitoring of:
- published credit ratings for financial institutions (minimum long term rating of A- or equivalent for UK counterparties; AA+ or equivalent for non-UK sovereigns) – this is lower than the A+ minimum adopted in 2011/12 and is in response to downgrades in credit ratings below A+ of many institutions considered to be systemically important to the UK financial system
  - sovereign support mechanisms
  - credit default swaps (where quoted)
  - share prices (where available)
  - economic fundamentals, such as a country's net debt as a percentage of its GDP
  - corporate developments, news, articles, market sentiment and momentum
  - subjective overlay – or, put more simply, common sense.

Any institution can be suspended or removed should any of the factors identified above give rise to concern.

The countries and institutions that meet the criteria for term deposits, Certificates of Deposit (CDs) and call accounts are included in Annex D. It should be noted that given increasing stress in financial markets and expansion of risks presented by the crisis in the Eurozone, the Council currently restricts its cash investments to UK banks, building societies, and other UK local authorities, and that Annex D sets out a wider list which would be appropriate if conditions were to change over the course of 2012/13 and investment counterparty risks were to reduce significantly.

It remains the Council's policy to make exceptions to counterparty policy established around credit ratings, but this is conditional and directional. What this means is that an institution that meets certain criteria may nonetheless still be suspended, but institutions not meeting the criteria will not be added.

- 7.7 **Council's Banker** – The Council banks with NatWest. At the current time, it meets the minimum credit criteria of A- (or equivalent) long term. Even if the credit rating falls below the Council's minimum criteria, NatWest will continue to be used for short term liquidity requirements (overnight and weekend investments) and business continuity arrangements.

## 8 Investment Strategy

- 8.1 With short term interest rates low for even longer, an investment strategy will typically result in a lengthening of investment periods, where cash flow permits, in order to lock in higher rates of acceptable risk adjusted returns. The problem in the current environment is finding an investment counterparty providing acceptable levels of counterparty risk.
- 8.2 In order to diversify an investment portfolio largely invested in cash, investments will be placed with a range of approved investment counterparties in order to achieve a diversified portfolio of prudent counterparties, investment periods and rates of return. Maximum investment levels with each counterparty will be set to ensure prudent diversification is achieved.
- 8.3 The Investment Strategy will provide flexibility to invest cash for periods of up to 364 days in order to access higher investment returns in the current low interest rate environment, although lending to UK local authorities can be for up to two years. Given that the existing confidence in the banking sector is at a low ebb and to increase levels of capital security, the Council intends to make greater use of lending to other local authorities which are commonly interested in borrowing for periods of up to two years. To facilitate this, the upper limit for lending beyond 364 days has been increased to £120m. In the case of deposits placed with UK local authorities, agreeing to re-lend these monies up to six months ahead of existing maturity dates for up to a further two years from such maturity dates will also be considered permissible. This will be shortened in respect of those institutions with a higher perceived credit risk, based on the creditworthiness criteria outlined in paragraph 7.6. For example, new investment deposits with banks and building societies are restricted to periods of up to 3 months at the present time.
- 8.4 An exception to this would be lending of up to a further £15m to UK local authorities or other similarly highly credit rated counterparties for up to 25 years specifically in relation to forecasted cash flow surpluses on the Council's 25-year Street Lighting PFI project. The objective would be to secure an investment income stream for the project based on a targeted interest rate of 4.0%.
- 8.5 Cash investments with longer than 364 days to maturity will be restricted to a maximum of £120m, with a maximum investment being placed with one institution of £20m.

## **9 The Use of Financial Instruments for the Management of Risks**

- 9.1 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.
- 9.2 Should this position change, the Council may seek to develop a detailed and robust risk management framework governing the use of derivatives, but this change in strategy will require the Council's approval.

## **10 2012/13 Minimum Revenue Provision Statement**

- 10.1 The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (SI 2008/414) place a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Secretary of State and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.
- 10.2 The four MRP options available are:
  - Option 1: Regulatory Method
  - Option 2: CFR Method
  - Option 3: Asset Life Method
  - Option 4: Depreciation Method

*NB This does not preclude other prudent methods.*

- 10.3 The MRP in 2012/13: Options 1 and 2 may be used only for supported expenditure which is where the borrowing costs are supported by extra revenue grant from the Government. Methods of making prudent provision for self financed expenditure include Options 3 and 4 (which may also be used for supported expenditure if the Council chooses).
- 10.4 The MRP Statement will be submitted to the Council before the start of the 2012/13 financial year. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement should be put to the Council at that time.
- 10.5 The Council will apply Option 1/Option 2 in respect of supported capital expenditure and Option 3/Option 4 in respect of unsupported capital expenditure.

And

MRP in respect of leases brought on Balance Sheet under the International Financial Reporting Standards (IFRS) based Accounting Code of Practice will match the annual principal repayment for the associated deferred liability.

## **11 Monitoring and Reporting on the Treasury Outturn and Prudential Indicators**

- 11.1 Treasury activity is monitored quarterly and reported internally to the County Treasurer. The Prudential Indicators will be monitored through the year by the County Treasurer and reported as set out below:

The County Treasurer will report to the Council on treasury management activity / performance and Prudential Indicators as follows:

- (a) a mid-year and year end review of treasury activity against the strategy approved for the year.
- (b) The Council will produce an outturn report on its treasury activity no later than 30 September after the financial year end.
- (c) The Audit Committee will be responsible for the scrutiny of treasury management activity and practices.

## **12 Other Items**

### 12.1 Training

CIPFA's Code of Practice requires the *responsible officer*, which is the County Treasurer, to ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

A treasury management workshop jointly presented by the County Treasurer and Arlingclose on 31 January 2012 provided members with an update in treasury matters.

The training needs of the Council's treasury management staff are subject to regular review.

### 12.2 Investment consultants

The County Treasurer uses Arlingclose Ltd as external treasury advisers for information, advice and assistance relating to borrowing and investment.

## Existing Debt and Investment Portfolio Position

	31 December 2011 Actual Portfolio £m
<b>External Borrowing:</b>	
Fixed Rate – PWLB	-316.9
Fixed Rate – Market	0
Variable Rate – PWLB	0
Variable Rate – Market	-73.0
<b>Total External Borrowing</b>	<b>-389.9</b>
<b>Other Long Term Liabilities:</b>	
- Finance Lease (Waste Contract)	-82.1
- Street Lighting PFI	-12.4
<b>Total Gross External Debt</b>	<b>-484.4</b>
<b>Investments:</b>	
<i>Managed in-house</i>	
- Short-term monies (Deposits / monies on call / MMFs)	257.9
- Long-term investments (maturities over 12 months)	60.0
<b>Total Investments</b>	<b>317.9</b>

## Prudential Indicators 2012/13 – 2014/15

### 1 Background

There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators.

### 2 Net Borrowing and the Capital Financing Requirement

This is a key indicator of prudence. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council should ensure that the net external borrowing does not, except in the short term, exceed the total of the Capital Financing Requirement (CFR) in the preceding year plus the estimates of any additional increases to the CFR for the current and next two financial years.

The County Treasurer reports that the Council had no difficulty meeting this requirement in 2011/12, nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

### 3 Estimates of Capital Expenditure and Capital Financing

- 3.1 This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax.

Capital Expenditure	2012/13 Estimate £m	2013/14 Estimate £m	2014/15 Estimate £m
<b>Total</b>	<b>188.4</b>	<b>201.6</b>	<b>159.8</b>

3.2 Capital expenditure will be financed as follows:

<b>Capital Financing</b>	<b>2012/13 Estimate</b>	<b>2013/14 Estimate</b>	<b>2014/15 Estimate</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
Capital receipts	25.5	14.7	5.7
Government grants and other income	99.9	75.4	97.1
Revenue contributions	30.1	57.5	32.2
Contributions from reserves	12.0	0.0	0.0
<b>Sub-total</b>	<b>167.5</b>	<b>147.6</b>	<b>135.0</b>
Borrowing (including internal)	20.9	54.0	24.8
<b>Total Financing</b>	<b>188.4</b>	<b>201.6</b>	<b>159.8</b>

#### 4 Ratio of Financing Costs to Net Revenue Stream

4.1 This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs. The definition of financing costs is set out in the Prudential Code.

4.2 The ratio is based on costs net of investment income.

<b>Ratio of Financing Costs to Net Revenue Stream</b>	<b>2012/13 Estimate</b>	<b>2013/14 Estimate</b>	<b>2014/15 Estimate</b>
	<b>%</b>	<b>%</b>	<b>%</b>
<b>Total</b>	<b>9.56</b>	<b>9.66</b>	<b>9.92</b>

## 5 Capital Financing Requirement

- 5.1 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and its financing.

<b>Capital Financing Requirement</b>	<b>31/03/2013 Estimate</b>	<b>31/03/2014 Estimate</b>	<b>31/03/2015 Estimate</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>Total</b>	<b>735.2</b>	<b>786.4</b>	<b>804.1</b>

## 6 Actual External Debt

- 6.1 This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

<b>Actual External Debt as at 31/03/2011</b>	<b>£m</b>
Borrowing	402.2
Other Long Term Liabilities	
- Finance Lease (Waste Contract)	82.1
- Street Lighting PFI	12.4
<b>Total</b>	<b>496.7</b>

## 7 Incremental Impact of Capital Investment Decisions

- 7.1 This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

<b>Incremental Impact of Capital Investment Decisions</b>	<b>2012/13 Estimate</b> £	<b>2013/14 Estimate</b> £	<b>2014/15 Estimate</b> £
Borrowing costs	0.57	3.16	4.74
Running expenses and revenue contributions to capital	0.36	0.38	0.34
<b>Increase in Band D Council Tax</b>	<b>0.93</b>	<b>3.54</b>	<b>5.08</b>

The increase in borrowing costs in 2013/14 and 2014/15 reflects the proposed use of prudential borrowing to finance proposals for additions to the capital programme of schemes for extra care housing, rural broadband and the schools managed IT service.

## 8 Authorised Limit and Operational Boundary for External Debt

- 8.1 The Council has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy and practice. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Council and not just those arising from capital spending reflected in the CFR.
- 8.2 The **Authorised Limit** sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Council. It is measured against all external borrowing items on the Balance Sheet, i.e., long and short term borrowing, overdrawn bank balances and long term liabilities. This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Council's existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.
- 8.3 The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.

- 8.4 The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

<b>Authorised Limit for External Debt</b>	<b>2012/13 Estimate</b>	<b>2013/14 Estimate</b>	<b>2014/15 Estimate</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
Borrowing	680	700	700
Other Long Term Liabilities	140	170	190
<b>Total</b>	<b>820</b>	<b>870</b>	<b>890</b>

- 8.5 The **Operational Boundary** links directly to the Council's estimates of the CFR and estimates of other cashflow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.
- 8.6 The County Treasurer has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the next meeting of the Council.

<b>Operational Boundary for External Debt</b>	<b>2012/13 Estimate</b>	<b>2013/14 Estimate</b>	<b>2014/15 Estimate</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
Borrowing	600	620	620
Other Long Term Liabilities	140	170	190
<b>Total</b>	<b>740</b>	<b>790</b>	<b>810</b>

## 9 Adoption of the CIPFA Treasury Management Code

- 9.1 This indicator demonstrates that the Council has adopted the principles of best practice.

<b>Adoption of the CIPFA Code of Practice in Treasury Management</b>
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The Council approved the adoption of the CIPFA Treasury Management Code at its meeting on 18 February 2010.
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The Council has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices.

## 10 Gross and Net Debt

- 10.1 The purpose of this treasury indicator is to highlight a situation where the Council is planning to borrow in advance of need.

<b>Gross and Net Debt</b>	<b>31/03/2013 Authorised £m</b>	<b>31/03/2014 Authorised £m</b>	<b>31/03/2015 Authorised £m</b>
Outstanding Borrowing (at nominal value)	379.1	368.6	354.1
Other Long-term Liabilities (at nominal value)	138.7	163.5	183.3
<b>Gross Debt</b>	<b>517.8</b>	<b>532.1</b>	<b>537.4</b>
<b>Less: Investments</b>	<b>160.0</b>	<b>150.0</b>	<b>140.0</b>
<b>Net Debt</b>	<b>357.8</b>	<b>382.1</b>	<b>397.4</b>

*N.B. CIPFA has acknowledged that this indicator does not work as was intended and is working on a revised one. This indicator will be amended once revised guidance has been received from CIPFA.*

## 11 Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

- 11.1 These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The upper limits for both fixed and variable rate exposure are based on the Operational Boundary and have been set to give the Council maximum policy flexibility.

	<b>2012/13 Estimate £m</b>	<b>2013/14 Estimate £m</b>	<b>2014/15 Estimate £m</b>
<b>Upper Limit for Fixed Interest Rate Exposure</b>	740	790	810
<b>Upper Limit for Variable Interest Rate Exposure</b>	740	790	810

## 12 Maturity Structure of Fixed Rate Borrowing

- 12.1 This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period and, in particular, during the course of the next ten years.
- 12.2 It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

Maturity structure of fixed rate borrowing	Existing level (or benchmark level)		
	Lower Limit at 31/03/11 %	Upper Limit for 2012/13 %	Upper Limit for 2012/13 %
under 12 months	2	0	50
12 months and within 24 months	2	0	50
24 months and within 5 years	10	0	50
5 years and within 10 years	15	0	75
10 years and within 20 years	28	0	75
20 years and within 30 years	39	0	75
30 years and within 40 years	4	0	100
40 years and within 50 years	0	0	100
50 years and above	0	0	100

## 13 Credit Risk

- 13.1 The Council considers security, liquidity and yield, in that order, when making investment decisions.
- 13.2 Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Council's assessment of counterparty credit risk.
- 13.3 The Council also considers alternative assessments of credit strength, and information on corporate developments of and market sentiment towards counterparties. The following key tools are used to assess credit risk:
- published credit ratings for financial institutions (minimum long term rating of A- or equivalent for UK counterparties; AA+ or equivalent for non-UK sovereigns)
  - sovereign support mechanisms
  - credit default swaps (where quoted)
  - share prices (where available)

- economic fundamentals, such as a country's net debt as a percentage of its GDP
- corporate developments, news, articles, market sentiment and momentum
- subjective overlay – or, put more simply, common sense.

13.4 Credit ratings continue to be the only indicator with prescriptive values. Other indicators of creditworthiness are considered in relative rather than absolute terms.

#### 14 Upper Limit for Total Principal Sums Invested over 364 Days

14.1 The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested.

<b>Upper Limit for total principal sums invested over 364 days</b>	<b>2011/12 Approved £m</b>	<b>2011/12 Revised £m</b>	<b>2012/13 Estimate £m</b>	<b>2013/14 Estimate £m</b>	<b>2014/15 Estimate £m</b>
	<b>60.0</b>	<b>120.0</b>	<b>120.0</b>	<b>100.0</b>	<b>80.0</b>

## Arlingclose's Economic &amp; Interest Rate Forecast – December 2011

	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
<b>Official Bank Rate</b>													
<b>Upside risk</b>					0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
<b>Central case</b>	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
<b>Downside risk</b>													
<b>1-yr LIBID</b>													
<b>Upside risk</b>	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
<b>Central case</b>	1.75	1.75	1.75	1.75	1.80	1.85	1.95	2.00	2.10	2.20	2.30	2.40	2.40
<b>Downside risk</b>	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
<b>5-yr gilt</b>													
<b>Upside risk</b>	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
<b>Central case</b>	1.30	1.35	1.40	1.50	1.60	1.70	1.80	2.00	2.10	2.30	2.40	2.50	2.50
<b>Downside risk</b>	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
<b>10-yr gilt</b>													
<b>Upside risk</b>	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
<b>Central case</b>	2.30	2.40	2.45	2.50	2.55	2.60	2.70	2.75	2.80	2.85	2.90	3.00	3.00
<b>Downside risk</b>	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
<b>20-yr gilt</b>													
<b>Upside risk</b>	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
<b>Central case</b>	3.05	3.05	3.10	3.20	3.25	3.30	3.35	3.40	3.45	3.50	3.60	3.75	3.75
<b>Downside risk</b>	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
<b>50-yr gilt</b>													
<b>Upside risk</b>	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
<b>Central case</b>	3.40	3.50	3.60	3.70	3.80	3.90	4.00	4.00	4.00	4.10	4.20	4.25	4.25
<b>Downside risk</b>	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25

- 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. It could be 2016 before official UK interest rates rise.
- The UK's safe haven status, the direct effect of QE and minimal prospect of an increase in policy rates are expected to keep gilt yields at their lows in the near term.
- A disorderly outcome to the Eurozone sovereign crisis remains a key economic, credit and political risk.

**Underlying Assumptions:**

- Financial market stress is expected to remain a feature of 2012. Rates within Interbank markets (where banks fund the majority of their day-to-day operations) have continued to climb. This dynamic was a characteristic of the 2008 banking crisis and whilst the authorities have flooded the markets with liquidity, it is still a strong indicator of market risk.

- Inflation has moderated back to 4.2% in December 2011 from what was considered to be its peak of 5.2% reached in September 2011. CPI is expected to drop gradually back towards the Bank of England's 2% target as the January 2011 VAT increase, the surge in oil prices and the large energy price hikes fall out of the twelve month comparison.
- Recent data and surveys suggest that since the summer the UK economy has lost the admittedly fragile momentum. Business and consumer surveys point to continued weakness in coming months. Public spending cuts, austerity measures, credit constraints, low business and consumer confidence could result in the economy stalling (Q3 excepted, when the 2012 Olympics will provide a temporary boost) and most likely pressure the Bank of England to provide further QE.
- Faltering global growth will not be helped by the considerable uncertainty and expansion of risks presented by the crisis in the Eurozone and gridlock in the US going into an election year. The knock-on effects could in turn weigh on growth in China and emerging market countries.
- Gilt supply is expected to be higher in 2012-13 than previously forecast by the Treasury. However, over the short-term, gilts will retain their safe-haven status as euro area contagion risks grow.
- Sizeable European bond redemptions and refinancing (Italy in particular) in the first half of 2012 remain significant challenges. Headwinds to fiscal convergence and treaty changes could intensify downgrade pressures on the AAA core nations as well as peripheral countries. The effectiveness of the European Financial Stability Fund (EFSF) may prove limited, increasing the possibility of a sovereign failure or the break-up of the euro area.

## Recommended Sovereign and Counterparty List

Country/ Domicile	Counterparty	Maximum Counterparty Limit £m
UK	NatWest	60
UK	Lloyds TSB	60
UK	Barclays	60
UK	HSBC	60
UK	Nationwide Building Society	60
UK	Santander UK	60
UK	Standard Chartered	60
Australia	Australia and NZ Banking Group	10
Australia	Commonwealth Bank of Australia	10
Australia	National Australia Bank	10
Australia	Westpac Banking Corp	10
Canada	Bank of Montreal	10
Canada	Bank of Nova Scotia	10
Canada	Canadian Imperial Bank of Commerce	10
Canada	Royal Bank of Canada	10
Canada	Toronto-Dominion Bank	10
Finland	Nordea Bank Finland	10
France	BNP Paribas	10
France	Credit Agricole	10
France	Société Générale	10
Germany	Deutsche Bank AG	10
Netherlands	ING Bank NV	10
Netherlands	Rabobank	10
Sweden	Svenska Handelsbanken	10
Switzerland	Credit Suisse	10
US	JP Morgan	10

*Please note this list could change if, for example, a counterparty/country is upgraded, and meets our other creditworthiness tools. Alternatively, if a counterparty is downgraded, this list may be shortened.*

### Glossary of Treasury Terms

Balances and Reserves	Accumulated sums that are maintained either earmarked for specific future costs or commitments or generally held to meet unforeseen or emergency expenditure.
Bank Rate	The official interest rate set by the Bank of England's Monetary Policy Committee and what is generally termed as the "base rate". This rate is also referred to as the 'repo rate'.
Bond	A certificate of debt issued by a company, government, or other institution. The bond holder receives interest at a rate stated at the time of issue of the bond. The price of a bond may vary during its life.
Capital expenditure	Expenditure on the acquisition, creation or enhancement of capital assets.
Capital Financing Requirement (CFR)	The Council's underlying need to borrow for capital purposes representing the cumulative capital expenditure of the local authority that has not been financed.
Capital receipts	Money obtained on the sale of a capital asset.
Cost of carry	The cost of "carrying" or holding a position. For example, if one takes out borrowing at 4% and invests the money at 1%, there is a cost of carry of 3%.
CPI	Consumer Price Index – the UK's main measure of inflation. Pensions are uprated using the CPI index.
Credit Rating	Formal opinion by a registered rating agency of a counterparty's future ability to meet its financial liabilities; these are opinions only and not guarantees.
Corporate Bonds	Corporate bonds are bonds issued by companies. The term is often used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies.
Diversification / diversified exposure	The spreading of investments among different types of assets or between markets in order to reduce risk.
ECB	European Central Bank.
Federal Reserve	The US central bank. (Often referred to as "the Fed").
General Fund	This includes most of the day-to-day spending and income.

Government Gilts	Gilts are bonds issued by the UK Government. They take their name from 'gilt-edged': being issued by the UK Government, they are deemed to be very secure as the investor expects to receive the full face value of the bond to be repaid on maturity.
IFRS	International Financial Reporting Standards.
Maturity	The date when an investment or borrowing is repaid.
Maturity profile	A table or graph showing the amount (or percentage) of debt or investments maturing over a time period. The amount or percent maturing could be shown on a year-by-year or quarter-by-quarter or month-by-month basis.
Money Market Funds (MMF)	Pooled funds which invest in a range of short term assets providing high credit quality and high liquidity.
Minimum Revenue Provision	An annual provision that the Council is statutorily required to set aside and charge to the Revenue Account for the repayment of debt associated with expenditure incurred on capital assets.
Non-Specified Investments	Term used in the Communities and Local Government Guidance and Welsh Assembly Guidance for Local Authority Investments. It includes any investment for periods greater than one year or those with bodies that do not have a high credit rating, use of which must be justified.
Premiums and Discounts	<p>In the context of local authority borrowing, (a) the premium is the penalty arising when a loan is redeemed prior to its maturity date and (b) the discount is the gain arising when a loan is redeemed prior to its maturity date. If on a £1 million loan, it is calculated* that a £100,000 premium is payable on premature redemption, then the amount paid by the borrower to redeem the loan is £1,100,000 plus accrued interest. If on a £1 million loan, it is calculated that a £100,000 discount receivable on premature redemption, then the amount paid by the borrower to redeem the loan is £900,000 plus accrued interest.</p> <p>PWLB premium/discount rates are calculated according to the length of time to maturity, current market rates (plus a margin), and the existing loan rate which then produces a premium/discount dependent on whether the discount rate is lower/higher than the coupon rate.</p>

Prudential Code	Developed by CIPFA and introduced on 1 April 2004 as a professional code of practice to support local authority capital investment planning within a clear, affordable, prudent and sustainable framework and in accordance with good professional practice.
Prudential Indicators	Indicators determined by the local authority to define its capital expenditure and asset management framework. They are designed to support and record local decision making in a manner that is publicly accountable; they are not intended to be comparative performance indicators
PWLB	Public Works Loans Board. It is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. The PWLB's function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments.
Quantitative Easing	In relation to the UK, it is the process used by the Bank of England to directly increase the quantity of money in the economy. It “does not involve printing more banknotes. Instead, the Bank buys assets from private sector institutions – that could be insurance companies, pension funds, banks or non-financial firms – and credits the seller’s bank account. So the seller has more money in their bank account, while their bank holds a corresponding claim against the Bank of England (known as reserves). The end result is more money out in the wider economy”. Source: Bank of England.
Revenue expenditure	Expenditure to meet the continuing cost of delivery of services including salaries and wages, the purchase of materials and capital financing charges.
RPI	Retail Prices Index. A monthly index demonstrating the movement in the cost of living as it tracks the prices of goods and services including mortgage interest and rent. Index-linked gilts are uprated using the RPI index.
Specified Investments	Term used in the Communities and Local Government Guidance and Welsh Assembly Guidance for Local Authority Investments. Investments that offer high security and high liquidity, in sterling and for no more than 1 year. UK Government, local authorities and bodies that have a high credit rating.

Supported Borrowing	Borrowing for which the costs are supported by the Government or third party.
Supranational Bonds	Instruments issued by supranational organisations created by governments through international treaties (often called multilateral development banks). The bonds carry a AAA rating in their own right. Examples of supranational organisations are the European Investment Bank, the International Bank for Reconstruction and Development.
Treasury Management Code	CIPFA's Code of Practice for Treasury Management in the Public Services.
Temporary Borrowing	Borrowing to cover peaks and troughs of cash flow, not to fund spending.
Term Deposits	Deposits of cash with terms attached relating to maturity and rate of return (interest).
Unsupported Borrowing	Borrowing which is self-financed by the local authority. This is also sometimes referred to as Prudential Borrowing.
Yield	The measure of the return on an investment instrument.