**Appendix 8**

# Treasury Management Strategy Statement and Investment Strategy 2011/12 to 2013/14

## 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 fire authorities to determine the Treasury Management Strategy Statement (TMSS) and Prudential Indicators on an annual basis. The TMSS also incorporates an Investment Strategy as required under the CLG's Investment Guidance.

1.2 CIPFA has defined Treasury Management as:

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

1.3 The Authority is responsible for its treasury decisions and activity. No treasury management activity is without risk. The successful identification, monitoring and control of risk are an integral element to treasury management activities and include Credit and Counterparty Risk, Liquidity Risk, Market or Interest Rate Risk, Refinancing Risk, and Legal and Regulatory Risk.

1.4 The strategy takes into account the impact of the Authority's Revenue Budget and Capital Programme on the Balance Sheet position, the current and projected Treasury position (Annex A), the Prudential Indicators and the outlook for interest rates (Annex B).

1.5 The Authority approved the adoption of the revised CIPFA Treasury Management Code (2009) at its meeting in February 2010. The Authority has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices.

1.6 All treasury activity will comply with relevant statute, guidance and accounting standards.

1.7 The treasury management strategy has been reviewed in the light of the appointment of treasury management advisers, Arlingclose, by the Treasurer, for the Authority. The strategy for borrowing previously focused on the new capital financing requirements of the capital programme and the replacement of maturing loans. Going forward the intention is to take a more active approach to managing the portfolio of existing borrowing looking for opportunities which may arise in an environment of changing interest rates to refinance some borrowing to offer improved revenue costs of capital financing. Consequently, the prudential indicators related to borrowing limits have been reviewed to set reasonable upper limits and yet enable flexibility within delegated powers for the Treasurer to secure opportunities which do arise.

1.8 The strategy reflects the changed capital financing environment for the Authority with the move to capital grant from supported borrowing. It is necessarily reflecting the proposal to the Authority to approve the capital programme for 2011/12 only and as a planning framework for the forward three years pending the detail of the capital settlement. The settlement is likely to trigger a review of the forward capital programme and thus the capital financing requirements.

1.9 For investments, the strategy takes account of the budget proposal to build reserves for use in the forward years, recognizing the potential for longer term investment opportunities.

1.10 The prudential indicators which are all covered in this report are:

- incremental impact of capital investment decisions
- ratio of financing costs to net revenue stream
- authorised limit
- operational boundary
- upper limit for fixed interest rate exposure
- upper limit for variable interest rate exposure
- maturity structure of fixed rate borrowing
- upper limit for total principal sums invested over 364 days.

1.11 A glossary of terms is provided in Annex E.

1.12 **This strategy recommends the following approvals:**

- **the Treasury Management Strategy for 2011/12 (Borrowing and Debt Rescheduling - Section 3, Investments - Section 4).**

- **Prudential Indicators – (NB: the Authorised Limit is a statutory limit).**

- **Minimum Revenue Provision (MRP) Statement – Section 6.**

- **use of Specified and Non-Specified Investments – Annexes C & D.**

- **that with effect from 1 April 2011 surplus funds invested with the County Council will attract the Bank of England's base rate, with any overdrawn position charged at minus base rate.**

- **that the Authority reaffirms its commitment to sharing any capital losses on pooled cash balances on a pro rata basis, whilst any losses on deposits specifically made on behalf of the HFRA should be borne in full by the Authority.**

## 2 Balance Sheet and Treasury Position

2.1 The underlying need to borrow for capital purposes, as measured by the Capital Financing Requirement (CFR), together with Balances and Reserves, are the core drivers of Treasury Management Activity. The estimates, based on the proposed Revenue Budget and Capital Programmes, are:

| | 31/03/2011 Estimate £m | 31/03/2012 Estimate £m | 31/03/2013 Estimate £m | 31/03/2014 Estimate £m |
|---|---|---|---|---|
| **Total Capital Financing Requirement** | 16.994 | 16.268 | 15.580 | 14.956 |
| **Less:**<br>Existing Profile of Borrowing<br>Other Long Term Liabilities | <br>-8.350<br>-2.331 | <br>-8.350<br>-2.331 | <br>-8.350<br>-2.331 | <br>-8.350<br>-2.331 |
| **Cumulative Maximum External Borrowing Requirement** | **6.313** | **5.587** | **4.899** | **4.275** |
| **Less:**<br>Balances & Reserves | <br>-6.220 | <br>-7.240 | <br>-7.083 | <br>-3.666 |
| **Cumulative Net Borrowing Requirement/(Investments)** | **0.093** | **-1.653** | **-2.184** | **0.609** |

The calculation on balances and reserves have been calculated assuming that the grant reduction and Improvement and Sustainability reserve balances are used 50% in 2012/13 and 50% in 2013/14.

2.2 The Authority's level of physical debt and investments is linked to these components of the Balance Sheet. The current portfolio position is set out at Annex A. Market conditions, interest rate expectations and credit risk considerations will influence the Council's strategy in determining the borrowing and investment activity against the underlying Balance Sheet position. The Authority will ensure that net physical external borrowing (i.e. net of investments) will not exceed the CFR other than for short term cash flow requirements.

### Estimates of capital expenditure

2.3 It is a requirement of the Prudential Code to ensure that capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax.

| Capital Expenditure | 2009/10 Actual £m | 2010/11 Estimate £m | 2011/12 Estimate £m | 2012/13 Estimate £m | 2013/14 Estimate £m |
|---|---|---|---|---|---|
| **Total** | **4.556** | **7.054** | **4.110** | **4.737** | **9.241** |

2.4 Capital expenditure is expected to be financed as follows:

| Capital Financing | 2010/11 Estimate £m | 2011/12 Estimate £m | 2012/13 Estimate £m | 2013/14 Estimate £m |
|---|---|---|---|---|
| Capital receipts | 0.139 | 0.425 | 1.620 | 4.385 |
| Government Grants | 1.286 | 2.410 | 2.410 | 2.410 |
| Capital payments reserve | 0.926 | 0.745 | - | - |
| Revenue contributions | 0.786 | 0.530 | 0.707 | 0.730 |
| Capital contributions | 0.011 | - | - | - |
| **Total Financing** | 3.148 | 4.110 | 4.737 | 7.525 |
| Supported borrowing | 2.419 | - | - | - |
| Unsupported borrowing | 1.487 | - | - | - |
| **Total Funding** | 3.906 | - | - | - |
| **Funding gap** | **-** | **-** | **-** | **1.716** |
| **Total Financing and Funding** | **7.054** | **4.110** | **4.737** | **9.241** |

**Incremental Impact of Capital Investment Decisions:**

2.5 As an indicator of affordability the table below 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.

| Incremental Impact of Capital Investment Decisions | 2010/11 Estimate £ | 2011/12 Estimate £ | 2012/13 Estimate £ | 2013/14 Estimate £ |
|---|---|---|---|---|
| Increase in Band D Council Tax | **1.18** | **0.84** | **1.12** | **1.16** |

2.6 The estimate for interest payments in 2011/12 is £0.473m and for interest receipts is £0.020m. The ratio of financing costs to the Council's net revenue stream 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 borrowing costs. The ratio is based on costs net of investment income.

| Ratio of Financing Costs to Net Revenue Stream | 2010/11 Estimate % | 2011/12 Estimate % | 2012/13 Estimate % | 2013/14 Estimate % |
|---|---|---|---|---|
| **Total** | **1.8** | **2.0** | **1.9** | **1.8** |

## 3 Borrowing and Rescheduling Strategy

3.1 The Authority's balance of actual gross borrowing plus other long-term liabilities is shown in Annex A. This is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

3.2 The **Authorised Limit** sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) and is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit). The authorised limits for 2011/12 and beyond have been increased to provide the Authority with maximum policy flexibility.

| Authorised Limit for External Debt | 2010/11 Estimate £m | 2011/12 Estimate £m | 2012/13 Estimate £m | 2013/14 Estimate £m |
|---|---|---|---|---|
| | 25.6 | 27.9 | 27.2 | 26.5 |

3.3 The **Operational Boundary** links directly to the Authority'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. The operational boundaries for 2011/12 and beyond have been increased to provide the Authority with maximum policy flexibility.

| Operational Boundary for External Debt | 2010/11 Estimate £m | 2011/12 Estimate £m | 2012/13 Estimate £m | 2013/14 Estimate £m |
|---|---|---|---|---|
| | 20.1 | 22.7 | 22.0 | 21.3 |

3.4 The 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 Authority.

3.5 The Authority will keep under review the following borrowing options:

- PWLB loans
- Borrowing from other local authorities
- Borrowing from institutions such as the European Investment Bank and directly from Commercial Banks
- Borrowing from the Money Markets
- Local authority stock issues
- Local authority bills
- Structured finance.

3.6 On 20 October 2010, the Comprehensive Spending Review (CSR) increased the cost of new local authority fixed rate loans to 1% above the cost of the Government's borrowing. However, the PWLB remains an attractive source of borrowing, given the transparency and control that its facilities continue to provide. The types of PWLB borrowing that are considered appropriate for a low interest rate environment are:

- Variable rate borrowing
- Medium-term Equal Instalments of Principal (EIP) or Annuity Loans
- Long-term Maturity loans, where affordable.

Capital expenditure levels, market conditions and interest rate levels will be monitored during the year in order to minimise borrowing costs over the medium to longer term and maintaining stability. The differential between debt costs and investment earnings, despite long term borrowing rates being at low levels, remains acute and this is expected to remain a feature during 2011/12. The "cost of carry" associated with medium- and long-term borrowing compared to temporary investment returns means that new fixed rate borrowing could entail additional short-term costs. The use of internal resources in lieu of borrowing may again, in 2011/12, be the most cost effective means of financing capital expenditure.

3.7 PWLB variable rates are expected to remain low as the Bank Rate is maintained at historically low levels for an extended period. Exposure to variable interest rates will be kept under regular review. Each time the spread between long-term rates and variable rates narrows by 0.50%, this will trigger a formal review point and options will be considered and decisions taken on whether to retain the same exposure or change from variable to fixed rate debt.

3.8 The rationale for rescheduling would be one or more of the following:

- Savings in interest costs with minimal risk

- Balancing the volatility profile (i.e. the ratio of fixed to variable rate debt) of the debt portfolio

- Amending the profile of maturing debt to reduce any inherent refinancing risks.

As opportunities arise, these will be considered by the Treasurer's staff.

3.9 Borrowing and rescheduling activity will be reported to the Authority.

3.10 The following Prudential Indicators allow the Authority 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 Authority maximum policy flexibility. The limits have been changed to enable the potential for a refinancing from, e.g., variable to fixed rate borrowing.

The Authority's existing level of fixed interest rate exposure is £8.35m and variable rate exposure is £2.35m – see Annex A.

| | 2010/11 Estimate £m | 2011/12 Estimate £m | 2012/13 Estimate £m | 2013/14 Estimate £m |
|---|---|---|---|---|
| **Upper Limit for Fixed Interest Rate Exposure** | 10.1 | 22.7 | 22.0 | 21.3 |
| **Upper Limit for Variable Interest Rate Exposure** | 15.5 | 22.7 | 22.0 | 21.3 |

3.11 The Authority will also limit and monitor large concentrations of fixed rate debt needing to be replaced. Limits in the following table are intended to control excessive exposures to volatility in interest rates when refinancing maturing debt, whilst providing policy flexibility.

| Maturity structure of fixed rate borrowing | Existing level at 31/12/10 % | Lower Limit for 2011/12 % | Upper Limit for 2011/12 % |
|---|---|---|---|
| under 12 months | 0 | 0 | 50 |
| 12 months and within 24 months | 0 | 0 | 50 |
| 24 months and within 5 years | 0 | 0 | 50 |
| 5 years and within 10 years | 3 | 0 | 75 |
| 10 years and within 20 years | 36 | 0 | 75 |
| 20 years and within 30 years | 61 | 0 | 75 |
| 30 years and within 40 years | 0 | 0 | 100 |
| 40 years and within 50 years | 0 | 0 | 100 |
| 50 years and above | 0 | 0 | 100 |

## 4 Investment Policy and Strategy

4.1 Guidance from CLG on Local Government Investments in England requires that an Annual Investment Strategy (AIS) be set.

4.2 The Authority's investment priorities are:

- security of the invested capital;
- liquidity of the invested capital;
- an optimum yield which is commensurate with security and liquidity.

4.3 Investments are categorised as 'Specified' or 'Non Specified' investments based on the criteria in the CLG Guidance. Potential instruments for the Authority's use within its investment strategy are contained in Annexes C and D. The Treasurer, under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on the core investment portfolio will be reported to the Authority.

4.4 'Specified investments' offer both high security and liquidity. All such investments should be in sterling and with a maturity of no more than a year. Such short-term investments made with the UK Government or a local authority will automatically count as specified investments. In addition, short-term sterling investments with banks and building societies with high credit ratings will count as 'specified investments'.

4.5 At the Finance & General Purposes Committee meeting on 15 January 2009, it was agreed that the interest rate receivable on surplus cash balances would be based on the seven-day notice rate and that any capital losses on pooled cash balances would be shared on a pro rata basis.

4.6 The seven-day notice rate has historically been seen as a reasonable rate for short-term, low value cash surpluses and has broadly aligned to the Bank of England's base rate as can be seen as follows:

| | Average Bank of England base rate | Average seven-day notice rate |
|---|---|---|
| 2006/07 | 4.8 | 4.9 |
| 2007/08 | 5.6 | 5.7 |
| 2008/09 | 3.5 | 3.7 |
| 2009/10 | 0.5 | 0.3 |
| 2010/11 | 0.5 | 0.3 |

4.7 However, the banking sector liquidity crisis since Autumn 2008 has meant that the seven-day notice rate is not currently such a good measure of risk and reward. Going forward, changes to banking regulations will adversely impact this seven-day notice rate as short notice monies will not count towards banks' minimum required capital ratios. Therefore, a change to the Bank of England's base rate is considered to be more appropriate for 2011/12 and thereafter.

4.8 During the year, the Authority may have sufficient surplus cash balances to allow direct long-term investment on the money markets. The Investment Strategy will provide flexibility to invest cash for periods of up to two years in order to access higher investment returns in the current low interest rate environment. All such investments would be made with reference to the outlook for the UK Bank Rate and money market rates – see Annex B.

4.9 The maximum investment limit with any single counterparty of £1m referenced in Annex C have been derived using an assumption that the maximum overall cash balance available at any one time would not exceed £8m. If the overall cash balance were to exceed this figure during 2011/12, the maximum counterparty limits would be increased by the same proportion under delegated powers of the Treasurer.

4.10 Any residual balances will be invested with the County Council, earning interest based on the Bank of England's base rate. When the position is overdrawn, the interest rate payable is similarly based on the Bank of England's base rate.

4.11 The Authority's current level of investments of £2.35m as at 31 December 2010 is presented at Annex A, which was all lent to the County Council.

4.12 In any period of significant stress in the markets, the default position is for investments to be made with the Debt Management Office or UK Treasury Bills. (The rates of interest from the DMADF are below equivalent money market rates, but the returns are an acceptable trade-off for the guarantee that the Authority's capital is secure.)

4.13 The Authority would select countries, and the institutions within them (see Annex C), for the counterparty list after analysis and careful monitoring of:

- Credit Ratings (minimum long-term A+ for counterparties; AA+ for countries)
- Credit Default Swaps (where quoted)
- GDP; Net Debt as a Percentage of GDP
- Sovereign Support Mechanisms/potential support from a well-resourced parent institution
- Share Prices (where quoted)
- Macro-economic indicators
- Corporate developments, news and articles , market sentiment.

4.14 The Authority will continue to analyse and monitor these indicators and credit developments on a regular basis and respond as necessary to ensure security of the capital sums invested.

4.15 The UK Bank Rate has been maintained at 0.5% since March 2009, and is anticipated to remain at low levels throughout 2011/12. Short-term money market rates are likely to remain at very low levels for an extended period which will have a significant impact on investment income.

4.16 The Authority has placed an upper limit for principal sums invested for over 364 days, as required by the Prudential Code. 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. The limit previously was zero and has been increased to £2m to reflect the changing approach on building and holding reserves set out in the budget report.

| Upper Limit for total principal sums invested over 364 days | 2010/11 Estimate £m | 2011/12 Estimate £m | 2012/13 Estimate £m | 2013/14 Estimate £m |
|---|---|---|---|---|
| | 2.0 | 2.0 | 2.0 | 2.0 |

4.17 As required by the Prudential Code, CLG on Local Government Investments in England requires that an Annual Investment Strategy (AIS) be set.

## 5 Outlook for Interest Rates

5.1 The economic interest rate outlook is attached at Annex B. The Authority will reappraise its strategy from time to time and, if needs be, realign it with evolving market conditions and expectations for future interest rates.

## 6 2011/12 Minimum Revenue Provision Statement

6.1 The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (SI 2008/414) place a duty on fire 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.

6.2 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.*

6.3 MRP in 2011/12: Options 1 and 2 may be used only for supported expenditure. Methods of making prudent provision for self financed expenditure include Options 3 and 4 (which may also be used for supported expenditure if the Authority chooses).

6.4 The MRP Statement will be submitted to the Authority before the start of the 2011/12 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 Authority at that time.

6.5 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 IFRS-based Code of Practice will match the annual principal repayment for the associated deferred liability.

6.6 Option 3/Option 4 is particularly relevant from 2011/12 as any new borrowing is expected to be unsupported.

## 7 Monitoring and Reporting on the Treasury Outturn and Prudential Indicators

Treasury activity is monitored quarterly and reported internally to the Treasurer. The Prudential Indicators will be monitored through the year by the Treasurer and reported as under :

The Treasurer will report to the Authority on treasury management activity / performance and Performance Indicators as follows:
(a) a mid-year and year end review of treasury activity against the strategy approved for the year.
(b) The Authority will produce an outturn report on its treasury activity no later than 30 September after the financial year end.
(c) Finance & General Purposes Committee will be responsible for the scrutiny of treasury management activity and practices.

## 8 Other Items

### Training

CIPFA's Code of Practice requires the *responsible officer* 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.

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

### Investment Consultants

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

ANNEX A

EXISTING PORTFOLIO PROJECTED FORWARD

| | Current Portfolio £m | 31 Mar 11 Estimate £m | 31 Mar 12 Estimate £m | 31 Mar 13 Estimate £m | 31 Mar 14 Estimate £m |
|---|---|---|---|---|---|
| **External Borrowing:** | | | | | |
| Fixed Rate – PWLB | -8.350 | -8.350 | -8.350 | -8.350 | -8.350 |
| Fixed Rate – Market | 0 | 0 | 0 | 0 | 0 |
| Variable Rate – PWLB | 0 | 0 | 0 | 0 | 0 |
| Variable Rate – Market | 0 | 0 | 0 | 0 | 0 |
| Total External Borrowing | -8.350 | -8.350 | -8.350 | -8.350 | -8.350 |
| Existing long-term liabilities | -8.350 | -8.350 | -8.350 | -8.350 | -8.350 |
| **IFRS Long Term Liabilities:** | | | | | |
| - Other Long Term Liabilities | -2.331 | -2.331 | -2.331 | -2.331 | -2.331 |
| - Operating Leases | -2.659 | -2.659 | -1.889 | -1.129 | -0.529 |
| **Total Gross External Debt** | -13.340 | -13.340 | -12.570 | -11.810 | -11.210 |
| **Investments:** | | | | | |
| *Managed in-house* | | | | | |
| - Lending to HCC | 2.350 | 0 | 0 | 0 | 0 |
| **Total Investments** | 2.350 | 0 | 0 | 0 | 0 |
| **(Net Borrowing Position)/ Net Investment position** | -10.990 | -13.340 | -12.570 | -11.810 | -11.210 |

ANNEX B

## Arlingclose's economic and Interest Rate Forecast – December 2010

| | Dec-10 | Mar-11 | Jun-11 | Sep-11 | Dec-11 | Mar-12 | Jun-12 | Sep-12 | Dec-12 | Mar-13 | Jun-13 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Official Bank Rate** | | | | | | | | | | | |
| **Upside risk** | - | 0.25 | 0.25 | 0.25 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| **Central case** | **0.50** | **0.50** | **0.50** | **0.75** | **1.00** | **1.25** | **1.50** | **2.00** | **2.50** | **2.75** | **2.75** |
| **Downside risk** | - | - | - | - 0.25 | - 0.50 | - 0.50 | - 0.50 | - 0.50 | - 0.50 | - 0.50 | - 0.50 |
| | | | | | | | | | | | |
| **1-yr LIBID** | | | | | | | | | | | |
| **Upside risk** | 0.25 | 0.25 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| **Central case** | **1.50** | **1.75** | **2.00** | **2.25** | **2.50** | **2.75** | **3.00** | **3.25** | **3.50** | **3.50** | **3.50** |
| **Downside risk** | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.50 | - 0.50 | - 0.50 | - 0.50 | - 0.50 | - 0.50 | - 0.50 |
| | | | | | | | | | | | |
| **5-yr gilt** | | | | | | | | | | | |
| **Upside risk** | 0.25 | 0.25 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| **Central case** | **2.00** | **2.25** | **2.75** | **3.25** | **3.50** | **3.75** | **4.00** | **4.00** | **4.00** | **4.00** | **4.00** |
| **Downside risk** | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 |
| | | | | | | | | | | | |
| **10-yr gilt** | | | | | | | | | | | |
| **Upside risk** | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| **Central case** | **3.50** | **3.75** | **3.75** | **4.00** | **4.25** | **4.50** | **4.75** | **4.75** | **4.75** | **4.75** | **4.75** |
| **Downside risk** | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 |
| | | | | | | | | | | | |
| **20-yr gilt** | | | | | | | | | | | |
| **Upside risk** | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.50 | 0.50 | 0.50 | 0.50 |
| **Central case** | **4.25** | **4.50** | **4.75** | **5.00** | **5.00** | **5.00** | **5.00** | **5.00** | **5.00** | **5.00** | **5.00** |
| **Downside risk** | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 |
| | | | | | | | | | | | |
| **50-yr gilt** | | | | | | | | | | | |
| **Upside risk** | 0.25 | 0.25 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| **Central case** | **4.25** | **4.25** | **4.50** | **4.75** | **4.75** | **4.75** | **4.75** | **4.50** | **4.50** | **4.50** | **4.50** |
| **Downside risk** | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 | - 0.25 |

- The recovery in growth is likely to be slow, uneven and more "Square root" than "V" shaped.
- The initial reaction to the Comprehensive Spending Review (CSR) is positive, but implementation risks remain.
- The path of base rates reflects the fragility of the recovery and the significantly greater fiscal tightening of the emergency budget. With growth and underlying inflation likely to remain subdued, the Bank will stick to its lower for longer stance on policy rates.
- Uncertainty surrounding Eurozone sovereign debt and the risk of contagion will remain a driver of global credit market sentiment.

Underlying assumptions:

- The framework and targets announced in the CSR to reduce the budget deficit and government debt are as announced in June and focuses on how the cuts are to be distributed. The next fiscal milestone will be the Office Of Budget Responsibility's assessment of the CSR's implications for growth, employment and inflation.
- The minutes of the Monetary Policy Committee's December meeting suggested a movement away from further Quantitative Easing (QE). Despite Money Supply being weak and growth prospects remaining subdued the MPC have gravitated towards increasing rates in the new year as global inflation continues to rise along with household inflation.

- Consumer Price Inflation is stubbornly above 3% and is likely to spike above 4% in January as VAT, Utilities and Rail Fares are increased.
- Unemployment remains near a 16 year high, at just over 2.5 Million, and is set to increase as the Public Sector shrinks. Meanwhile employment is growing but this is mainly due to part time work, leaving many with reduced income.
- Recently announced Basel III capital/liquidity rules and extended timescales are positive for banks. Restructuring of UK banks' balance sheets is ongoing and expected to take a long time to complete. This will be a pre-condition for normalisation of credit conditions and bank lending.
- Mortgage repayment, a reduction in net consumer credit and weak consumer confidence are consistent with lower consumption and therefore future trend rates of growth, despite Q3's fairly strong performance.
- The US Federal Reserve downgraded its outlook for US growth; the Fed is concerned enough to signal further QE through asset purchases. Industrial production and growth in the Chinese economy are showing signs of slowing. Both have implications for the global economy.

ANNEX C

## Specified Investments

### Specified Investments identified for use by the Authority

Specified Investments will be those that meet the criteria in the CLG Guidance, i.e. the investment

- is sterling denominated
- has a maximum maturity of 1 year
- meets the "high credit quality" as determined by the Authority or is made with the UK government or is made with a local authority in England, Wales, Scotland or Northern Ireland or a parish or community council.
- the making of which is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate).

"Specified" Investments identified for the Authority's use are:

- Deposits in the DMO's Debt Management Account Deposit Facility
- Deposits with UK local authorities
- Deposits with banks and building societies
- Gilts: (bonds issued by the UK government)
- Bonds issued by the European Investment Bank (EIB)
- Treasury-Bills (T-Bills)
- Local Authority Bills (LA Bills)
- AAA-rated Money Market Funds

For credit rated counterparties, the minimum criteria will be the lowest equivalent short-term and long-term ratings assigned by Fitch, Moody's and Standard & Poor's (where assigned).

*Long-term minimum: A+(Fitch); A1 (Moody's;) A+ (S&P)*
*Short-term minimum: F1 (Fitch); P-1 (Moody's); A-1 (S&P)*

The Council will also take into account information on corporate developments of and market sentiment towards investment counterparties.

| Country/ Domicile | Counterparty | Maximum Counterparty Limit £m |
|---|---|---|
| UK | Santander UK Plc | 1 |
| UK | Lloyds TSB | 1 |
| UK | Barclays Bank Plc | 1 |
| UK | Clydesdale Bank | 1 |
| UK | HSBC Bank Plc | 1 |
| UK | Nationwide Building Society | 1 |
| UK | NatWest | 1 |
| UK | Standard Chartered Bank | 1 |
| Australia | Australia and NZ Banking Group | 1 |
| Australia | Commonwealth Bank of Australia | 1 |
| Australia | Westpac Banking Corp | 1 |
| Canada | Bank of Montreal | 1 |
| Canada | Bank of Nova Scotia | 1 |
| Canada | Canadian Imperial Bank of Commerce | 1 |
| Canada | Royal Bank of Canada | 1 |
| Canada | Toronto-Dominion Bank | 1 |
| Finland | Nordea Bank Finland | 1 |
| France | BNP Paribas | 1 |
| France | Credit Agricole CIB (Credit Agricole Group) | 1 |
| France | Credit Agricole SA (Credit Agricole Group) | 1 |
| France | Société Générale | 1 |
| Germany | Deutsche Bank AG | 1 |

| | | |
|---|---|---|
| Netherlands | ING Bank NV | 1 |
| Netherlands | Rabobank | 1 |
| Sweden | Svenska Handelsbanken | 1 |
| Switzerland | Credit Suisse | 1 |
| US | JP Morgan | 1 |

*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.*

ANNEX D

**Non-Specified Investments determined for use by the Authority**

Having considered the rationale and risk associated with Non-Specified Investments, the following have been determined for the Authority's use:

| | **In-house use** | **Use by fund managers** | **Maximum maturity** |
|---|---|---|---|
| ▪ Deposits with banks and building societies<br>▪ CDs with banks and building societies | ✓<br>✓ | <br>✓ | 2 years |
| ▪ Gilts<br>▪ Bonds issued by multilateral development banks<br>▪ Bonds issued by financial institutions guaranteed by the UK government<br>Sterling denominated bonds by non-UK sovereign governments | ✓ (on advice from treasury advisor) | ✓ | |
| Government guaranteed bonds and debt instruments issued by corporate bodies | ✓ | ✓ | |
| Non-guaranteed bonds and debt instruments issued by corporate bodies | ✓ | ✓ | |

In determining the period to maturity of an investment, the investment should be regarded as commencing on the date of the commitment of the investment rather than the date on which funds are paid over to the counterparty.

ANNEX E

## Glossary of Treasury Terms

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|---|---|
| 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 at 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 5% and invests the money at 2%, there is a cost of carry of 3%. |
| CPI | Consumer Price Index – the UK's main measure of inflation. |
| 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. |

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| 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 Authority 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 | 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.<br><br>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.<br><br>*The calculation of the total amount payable to redeem a loan borrowed from the Public Works Loans Board (PWLB) is the present value of the remaining payments of principal and interest due in respect of the loan being repaid prematurely, calculated on normal actuarial principles. More details are contained in the PWLB's lending arrangements circular. |
| Prudential Code | Developed by CIPFA and introduced on 01/4/2004 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 the 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. |

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| 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. Pensions and index-linked gilts are uprated using the RPI index. |
| Specified Investments | Term used in the CLG 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. |