Treasury Management Strategy Statement

and Annual Investment Strategy

2012-13

1. Background and Legislation

1.1. The Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") and the Prudential Code require local authorities to set a Treasury Management Strategy Statement (TMSS) and Prudential Indicators (PIs) on an annual basis. The TMSS also includes the Annual Investment Strategy (AIS) that is a requirement of the CLG's Investment Guidance.

1.2 The purpose of this TMSS is, therefore, to approve:

- The Council's Treasury Management Strategy for 2012-13
- The Council's Annual Investment Strategy for 2012-13
- Prudential Indicators for 2012-13, 2013-14 and 2014-15 and
- The basis for splitting the long term loans outstanding at 31st March 2012 into a General Fund Pool and a HRA Pool

1.3 The Council is responsible for its treasury decisions and activity and treasury management is about managing risks that are inherent within this. No treasury management activity is without risk and simply doing nothing has risks associated with it.

1.4 As per the requirements of the Prudential Code, the Council adopted the CIPFA Treasury Management Code at a meeting of full Council on 26th February 2009.

1.5 All of the Council's treasury activity will comply with relevant statute, guidance and accounting standards and when dealing with treasury management advisers, money market brokers, investment banks and credit rating agencies the Council will be mindful of the requirements of the Bribery Act 2011.

2. Balance Sheet Position

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 A council that is fully externally borrowed will have long term loans, finance lease liabilities and PFI liabilities outstanding that are broadly equal to its CFR. In such cases the level of cash held by the Council will be broadly equal to its usable reserves.

2.3 A council that has some internal borrowing will have long term loans, finance lease liabilities and PFI liabilities outstanding that are below the level of its CFR. In such cases the level of cash held by the Council will be below the level of usable reserves.

2.4 The Council's current level of debt and investments is set out at **Appendix A**.

2.5 The Council is able to borrow funds (ie raise external loans) in excess of the current level of its CFR. It is able, should it so choose, to raise loans with a value up to the projected level of the CFR in 2014-15 (ie up to 3 years in advance). The Council is only likely to raise such loans (ie borrow in advance of need) if it feels the benefits of borrowing now at current interest rates compared to where they are expected to be in the future, outweighs the cost and risks associated with holding the proceeds until the borrowing is actually required.

2.6 The forecast movement in the CFR in coming years is one of the Prudential Indicators (PIs) that the Council must set each year. This movement in the CFR together with scheduled loan repayments 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

	2011-12 Estimate £m	2012-13 Estimate £m	2013-14 Estimate £m	2104-15 Estimate £m
General Fund CFR	259	279	300	319
HRA CFR	**96	103	101	99
Total CFR	355	382	401	418
Less: Existing Profile of Borrowing and Other Long Term Liabilities - General Fund - HRA	 (137) (96)	 (137) (103)	 (137) (101)	 (132) (99)
Cumulative Maximum External Borrowing Requirement	122	142	163	187
Usable Reserves	(86)	(83)	(82)	(81)
Cumulative Net Borrowing Requirement/(Investments)	36	59	81	106

** this figure reflects the potential increase following reform of the council housing finance subsidy system.

2.7 Table 1 shows that the capital expenditure plans of the Council cannot be funded entirely from sources other than external borrowing. At the present moment in time the Council is delaying the raising of new long term loans by using the cash represented by its reserves and working capital balances (ie the excess of its short term creditors over its short term debtors). This position cannot be maintained indefinitely. This is especially so at a time when the Council is funding capital expenditure from borrowing. It is likely therefore that during the year 2012-13 the Council will need to raise new long term loans.

3. Self-Financing of Housing

3.1 The reforms involve a removal of the housing subsidy system by offering 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 currently estimated at £91m.

In **Appendix B** revisions are made to the Prudential Indicators for 2011-12 to reflect the increase in borrowing in relation to the self-financing settlement.

3.2 Implementation of the final financing solution following the Executive meeting of 2nd November 2011, has been delegated, within approved parameters, to the Director of Resources (s151 officer), in conjunction with the Director of Regeneration and Culture and Executive Members for Resources and Prosperity.

3.3 As part of the reform of the council housing finance subsidy system there will be a need for all councils with a housing revenue account to split their existing loans (at 31st March 2012) between the General Fund Pool element and the Housing Revenue Account (HRA) element.

3.4 The guidance issued by CIPFA in respect of this split states that the allocation should result in no detriment to the general fund, should be broadly equitable between the general fund and the HRA and future borrowing decisions by the general fund should not impact on the HRA.

3.5 Prior to raising £91million of loans from the PWLB to make the necessary payment to CLG, it is estimated that the capital financing requirement of the HRA will be £5 million. Using the CIPFA methodology the HRA should therefore be allocated loans of around £5 million at 31st March 2012 also.

3.6 The expectation is that the Council's loans portfolio at 31st March 2012 will be largely unchanged from the loans inherited from the 3 former district councils and the former county council on 1st April 2009. The only change will have been a scheduled repayment of £500k made in July 2011.

3.7 Only 1 of the 3 former district councils and the former county council had a housing revenue account. This Council was Ellesmere Port and Neston Borough Council. The loans inherited from Ellesmere Port and Neston Borough Council that will still be outstanding at 31st March 2012 total £5 million.

3.8 Given that the capital financing requirement of the HRA at 31st March 2012 will be broadly in line with the outstanding loans inherited from Ellesmere Port and Neston Borough Council at that date it would reasonable to allocate these loans to the HRA. This would leave all the loans inherited from the former Chester City Council (there were no outstanding loans inherited from Vale Royal Borough Council) and the former county council allocated to the general fund.

3.9 This approach has been discussed with the Council's treasury management advisers. The view of the advisers is that this approach seems reasonable and equitable. The reasonableness and fairness of this allocation can be seen from the following

	General Fund Loans	HRA loans
Average rate of interest payable	4.67%	4.65%
Average maturity period	31.14 years	31.64 years

3.10 Members are therefore asked to approve the above basis as the means of allocating the council's outstanding long term loans at 31st March 2012 between the general fund and the HRA.

3.11 Post 31st March 2012 the Council will notionally have 2 loans pools. One pool will be the HRA pool which will comprise of

i) the £5 million loan inherited from the former Ellesmere Port and Neston Borough Council,

ii) the £91 million of loans raised from the Public Works Loans Board in order to make the £91 million the Council needs to pay the CLG under the reforms to the council housing finance subsidy system,

and

iii) all other loans raised specifically on behalf of the HRA post 31st March 2012

The second pool, the general fund pool will comprise of

i) All of the loans inherited from the former Chester City Council and the former County Council

and

ii) all other loans raised specifically on behalf of the general fund post 31st March 2012

3.12 The likelihood is that the Council will raise the £91 million of loans that it needs to raise in March 2012, in respect of the HRA debt transfer, from the Public Works Loans Board (PWLB). The reasons for this are that the PWLB

a) has organisational size that allows it to advance such loans without putting an undue level of risk on either itself or the Council,

b) offers the widest range of types of loans,

c) offers the widest range of repayment periods,

d) allows early repayment of existing loans on previously agreed terms at a time of the Council's choosing (should the Council so wish),

and

e) will be offering a 'special' rate of interest on loans raised to fund the payment to be made to CLG under the reforms to the council housing finance subsidy system. It is estimated that the special rate will be around 0.85% lower than the 'normal' PWLB rates. Based on loans totalling £91 million this would generate an annual saving in interest payable of over £770,000.

3.13 At this stage it is proposed that the £91 million of loans to be raised from the PWLB to fund the payment to be made to the CLG on 28th March 2012 will comprise of the following

- 80% of the loans will be raised in the form of 30 year annuity loan
- the remaining 20% will be raised as a variable rate maturity loan for a period of 5 years. At the end of the 5 year period the loan will be converted into a 25 year fixed rate annuity loan.

An annuity loan is one where the amounts repaid under the loan agreement remain the same for the whole of the loan period. In the early years the half yearly payments comprise mainly of interest with just a small element of principal repayment. As time passes the amount of interest within each payment falls and the principal element increases. At the end of the loan period the whole of the original amount borrowed will have been repaid in full.

A maturity loan is one where only interest is paid to the lender during the life of the loan. The whole of the original amount borrowed is repaid on the last day of the loan period.

3.14 The rationale for choosing such a structure is 3 fold. Firstly it is affordable within the parameters of the HRA's 30 year business plan. Secondly it allows the Council to secure the benefits of the 'special' rate of interest on a high proportion of the loans raised for the whole of the 30 year period (ie it significantly reduces interest rate risk). Thirdly it ensures that repayment of the loan starts from the date of the first half yearly payment of interest and principal. Raising 20% of the loans as variable rate loans provides the benefit of a much reduced interest cost in the early years of the business plan. This reduced interest costs helps the HRA to achieve its aim of meeting decency standards within the next 5 to 7 years.

3.15 In addition to raising the £91 million of PWLB loans it is also proposed to raise a further £9m of variable rate maturity loans from the PWLB for a period of 7 years. These loans will be taken out (within the overall debt ceiling) in order to support the HRA's aim of achieving decency within a 5 to 7 year period. At the end of the 7 year loan period the HRA expects to have sufficient resources available to enable the loan to be repaid in full without any need for a replacement loan to be raised.

4. Interest Rate Forecast

4.1 The economic and interest rate forecast provided by the Council's treasury management advisor (Arlingclose Ltd) is attached at **Appendix C**. The Council will keep its treasury management strategy under constant review in response to evolving economic, political and financial events.

5. Borrowing Strategy

5.1 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. Of particular significance will be the difference (both absolute and relative) between the 2 rates and the period over which such differences are expected to prevail. The interest rate forecast provided in **Appendix C** indicates that an acute difference between short and longer term interest rates is expected to continue for several months / years. This difference creates a so called "cost of carry" for any new longer term borrowing where the proceeds are temporarily held as investments (pending their being spent) because of the difference between the amount of interest paid on the borrowing (the higher amount) and the amount that can be earned on the investment (the lower amount). Whilst the cost of carry can be assumed to be a reasonably short-term issue (ie the proceeds from the raising of the new loan are spent within a short time of the loan having been raised) given that new long term loans are raised for long 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. Furthermore any costs of carry incurred in a financial year must be met from that year's budget. Such costs cannot be carried forward and amortised over the life of the loan.

5.2 It is estimated that the Council will be required to borrow up to £20 million in 2012-13. The Council will adopt a flexible approach to this borrowing in consultation with its treasury management advisers, Arlingclose Ltd. The following factors will be considered prior to undertaking any external borrowing:

- Affordability (ie cost);
- Maturity profile of existing debt; (ie date of repayment)
- Interest rate and refinancing risk; (ie fixed rate or variable rate)
- Borrowing source (ie Public Works Loans Board or other body)

6. Sources of Borrowing and Portfolio Implications

6.1 In conjunction with advice from its treasury advisor, Arlingclose Ltd, the Council will keep under review the following borrowing sources:

- Public Works Loans Board (PWLB)
- Local authorities (including Pension Funds)
- Commercial banks
- European Investment Bank
- Money markets
- Capital markets (stock issues, commercial paper and bills)
- Structured finance
- Leasing

6.2 The current high cost of carry would ordinarily result in Councils having a preference for raising new long term loans in the form of shorter dated (ie up to 10 years) and variable rate borrowings. This type of borrowing injects volatility (ie potential variability in the amount of interest paid on a given set of loans) into the debt portfolio in terms of interest rate risk. This volatility is, however, counterbalanced by the affordability and alignment of borrowing costs with investment returns (ie if the rate of interest payable on the Council's variable rate loans increases then the rate of interest earned on the Council's cash balances will also increase)

6.3 The Council's exposure to shorter dated and variable rate borrowing will be kept under regular review by reference to the difference or spread between variable rate and longer term borrowing costs. A narrowing in this spread from its current level of more than 0.5% will result in an immediate and formal review of the borrowing strategy to determine whether the exposure to shorter dated and variable rates should be maintained or altered. The nature of PWLB variable rate loans is such that they can quickly and easily repaid and replaced with fixed rate loans at little or no cost

6.4 The Council has £22m exposure to LOBO loans (Lender's Option Borrower's Option) of which £12m of these can be "called" during 2012-13. A LOBO loan is "called" when the lender exercises their right to change the rate of interest payable on the loan. At this point the borrower can accept the revised terms (ie pay the higher rate of interest) 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.

6.5 Should one of the Council's LOBOs be called then the situation will be discussed with the Council's treasury management 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. In most cases the new rate of interest is set at such a penal rate that the only sensible choice open to the borrower is to repay the loan.

7. Debt Rescheduling

7.1 The Council's portfolio of PWLB loans can be restructured by prematurely repaying loans and refinancing them on similar or different terms to achieve

- A saving in (risk adjusted) interest costs
  or
- A rebalancing of the interest rate structure within the loans portfolio
  or
- A changing of the maturity profile of the loans portfolio

7.2 The lower interest rate environment and unfavourable changes to the rules regarding the premature repayment of PWLB loans have adversely affected the ability of councils to undertaken meaningful debt restructuring. Nonetheless occasional opportunities do still arise from time to time. The Council will continually monitor the opportunities for undertaking debt rescheduling opportunities.

7.3 Borrowing and rescheduling activity will be reported to the full Council and Audit and Governance Committee in the Annual Treasury Management Report and in the regular treasury management reports presented to the Audit and Governance Committee.

8. Annual Investment Strategy

8.1 In accordance with Investment Guidance issued by the CLG and best practice, this Council's primary objective in relation to the investment of public funds remains the security (ie preservation) of capital. The liquidity or accessibility of the Council's deposits and investments is a secondary consideration. The yield (rate of return) earned on deposits and investments, whilst important, will only be considered once the security and liquidity objectives have been satisfied. ie the return of the capital takes precedence over the return on the capital.

8.2 Financial markets remain in a heightened state of distress as a result of the excessive and poor performing debt within the markets. In some instances, Greece and Italy being the most notable examples, the extent and implications of the debt that has been built up has lead to a sovereign debt crisis together with a banking crisis the outcome of which is still largely unknown. It is against this backdrop of uncertainty that the Council's investment strategy is being framed.

8.3 Investments are categorised as "Specified" or "Non-Specified" within the investment guidance issued by the CLG.

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's and are not deemed capital expenditure investments under Statute. Non specified investments are all those investments that fall outside of the strict definition of a specified investment. All councils have the power to use specified investments. Each council must choose for itself what types, if any, of non-specified investments it wishes to be able to use. Each council must also choose to what extent it wishes to use such instruments (ie how much it wishes to invest in each type of non-specified investments and how much it wishes to invest in non-specified investments in total).

8.4 The types of investments that will be used by the Council and whether they are specified or non-specified investments are as follows:

Table 2: Specified and Non-Specified Investments

Investment	Specified	Non-Specified
Term deposits with UK banks and building societies	✓	✓
Term deposits with other UK local authorities	✓	✓
Certificates of deposit with UK banks and building societies	✓	✓
UK Government Bonds issued for longer than 1 year (Gilts)	✓	✓
UK Government Bonds issued for 1, 3 or 6 months Treasury Bills (T-Bills)	✓	×
Bonds issued by Multilateral Development Banks (eg European Investment Bank, 'World' Bank)	✓	✓
Local Authority Bills	✓	×
Commercial Paper	✓	×
Corporate Bonds	✓	✓
AAA rated Money Market Funds	✓	×
Other Money Market and Collective Investment Schemes	✓	✓
Debt Management Account Deposit Facility	✓	×

8.5 A number of amendments have been made to the investment strategy for the year 2012-13 (when compared to the investment strategy of the year 2011-12). The amendments are the Council's response to changes in the CLG Guidance (on local authority investments) and evolving conditions in financial markets.

8.6 The principal amendments are in relation to the individual institutions with which the Council is prepared to lend its funds (ie a change in minimum credit rating requirement). A minor amendment has also been made so as to include corporate bonds in the list of investments (both specified and non-specified) that the Council can use. Previously the purchase of a corporate bonds had been treated as capital expenditure and its sale proceeds as a capital receipt. This treatment will cease to apply with effect from 1st April 2012.

8.7 The Council, with advice from its advisors Arlingclose Ltd, will select the countries and financial institutions that the Council will lend monies to after analysis and ongoing monitoring of:

- Published credit ratings for financial institutions (minimum long term rating of A- or equivalent for 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 financial system. Since the financial crisis of 2008 then has been a noticeable drift downwards in the credit ratings assigned to all banks.
- Credit default swaps (CDS) (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.

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

The countries and institutions that meet the criteria for term deposits, Certificates of Deposit (CDs) and call accounts are included in **Appendix D**.

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 criteria may be suspended, but institutions not meeting criteria will not be added.

8.8 **Authority's Banker** – The Council banks with the Co-operative Bank. At the current time, the Co-operative Bank does meet the minimum credit criteria of A- (or equivalent) long term. In the event of the Co-operative Bank's credit rating falling below the Council's minimum criteria of A- then the Council will continue to use the Bank for short term liquidity requirements (overnight and weekend investments) and business continuity arrangements providing the credit ratings remains above BBB- (or equivalent). A credit rating of lower than BBB- is one that it assigned to non-investment grade assets (or junk bonds).

9. Investment Strategy

9.1 With short term interest rates forecast to remain at low levels for even longer (than previously forecast), an investment strategy will typically see an organisation investing for longer and longer periods, where cash flow permits, in order to lock into higher rates of acceptable (risk adjusted) returns. The problem in the current environment is finding an investment counterparty (ie bank or building society) providing acceptable levels of counterparty risk (ie certainty that the amount invested will be returned in full on the due date).

9.2 In order to diversify an investment portfolio largely invested in cash, investments will, where possible, be placed with a range of approved investment counterparties for a range of investment periods at a variety of interest rates. Maximum investment levels with each counterparty will be set to ensure prudent diversification is achieved (ie all the Council's eggs are not put in one basket).

9.3 Money market funds (MMFs) will also be utilised by the Council. Whilst MMFs provide good diversification, in accordance with good treasury management practice, the Council will seek to diversify any exposure to MMFs by utilising more than one. The Council will also restrict its exposure to those MMFs with a lower level of funds under management. Consequently the amount the Council will hold in an individual MMF will not exceed the lower of 0.5% of the net asset value of the MMF or £20 million. In the case of those money market funds that invest solely in gilts and treasury bills issued by the UK Government (so called Govy money market funds) the limit will be set at the lower of 1.0% of the net asset value of the MMF or £15 million.

9.4 The HRA's aim to achieve decency within 5 to 7 years, and the associated high level of capital expenditure payments, will mean that in the early years of the 30 year business plan the HRA will have little or no surplus cash balances available to it. Any surplus cash balances that the HRA has will be managed alongside those of the general fund. At each year end the HRA will be credited with the interest earned on its surplus cash balances.

10. The Use of Financial Instruments for the Management of Risks (ie the use of derivatives)

10.1 Derivatives are financial instruments whose value is derived from other assets such as bonds, commodities or shares. They have evolved in order to try and reduce risk and can be thought of a type of insurance against adverse movements in the price of bonds, commodities or shares. Derivatives include, amongst other things, the use of futures, options and interest rate swaps.

10.2 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. The Council does not presently see itself being in a situation whereby it will be appropriate, necessary or desirable to use derivatives and therefore has no intention of using derivatives in the foreseeable future.

10.3 Should this position change then a further report will be brought before Members at full Council explaining why the use of derivatives is considered appropriate, what types of derivatives it is proposed to use, the expected impact from the use of the derivative(s) (in terms of mitigating / managing a clearly identified risk) and seeking Member approval to the use of such derivatives. It is expected that the use of derivatives would only be necessary in those situations where the Council faces a significant financial risk that could potentially have a material impact on the overall financial health of the Council.

10.4 The Council will only consider using derivatives once it has established that it has the power to use derivatives, that it has fully understood the risks and rewards from using the derivative and after taking proper advice on the use of such derivatives has actively considered that advice.

10.5 The Council will also only use derivatives for the prudent management of the Council's own affairs (ie operational reasons). Derivatives will not be used for trading or speculative purposes.

11. Balanced Budget Requirement

11.1 The Authority complies with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget. This means that the Council has set its Council Tax at a level sufficient to meet its expenditure plans after taking account of all other sources of income.

12. Monitoring and Reporting on the Treasury Outturn and Prudential Indicators

12.1 The Director of Resources will report to the following Member bodies on treasury management activity / performance and Performance Indicators as follows:

- The Audit and Governance Committee will receive quarterly reports updating them on the progress made by the Council in respect of treasury management activities in the year to date
- Full Council will receive the Treasury Management Strategy Report (including the Annual Investment Strategy) prior to the start of the financial year
- Full Council will receive the Treasury Management Mid Year Review Report prior to the end of December each year
- Full Council will receive the Treasury Management Annual (Stewardship) Report prior to the end of September in the following financial year
- Corporate Select Panel will be responsible for the scrutiny of treasury management activity and practices.

13. Training

13.1 CIPFA's Code of Practice requires the Director of Resources 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.

To date training sessions on treasury management have been provided in January 2010, February 2010 and September 2010. These sessions were open to all Members. Further training sessions will be held during the year 2012-13 once final details of the reform of the Council Housing Finance Subsidy System is known.

13.2 Part of the services provided by the Council's treasury management advisers , Arlingclose, under the new contract starting on 1st April 2012 comprises 1 day's training for Members of the Council on the subject of treasury management. It is proposed to open this training session, which it is hoped to hold some time in the early summer, to all Members of the Council. It will, however, be particularly relevant to Members of Audit & Governance Committee. The Finance Department will liaise with Democratic Services to arrange the most suitable time and date on which to hold such training.

14 Treasury Management Advisors

14.1 The CLG's Guidance on local government investments recommend that the Investment Strategy should state:

- Whether and, if so, how the authority uses external contractors offering information, advice or assistance relating to investment and
- How the quality of any such service is controlled.

14.2 The Council has put in place a clearly defined service specification that it expects its treasury management advisers to provide. This specification is agreed with the adviser prior to the contract starting. Performance against the service specification is monitored on a regular basis by those officers of the Council dealing with treasury management activities.

14.3 The existing contract that the Council has for treasury management advice ends on 31st March 2012. A new service specification has recently been agreed and quotations sought for the provision of that service. Following an evaluation of the 3 quotations (which included a written submission) and presentation from each of the 3 advisory firms the Council has reappointed the incumbent adviser for a further period of 3 years commencing on 1st April 2012.

Appendix A – Existing Investment & Debt Portfolio Position (Section 2.4)

	31/12/11 Actual Portfolio £m
External Borrowing:	
Fixed Rate – PWLB	118
Fixed Rate – Market	22
Variable Rate –PWLB	**-**
Variable Rate– Market	**-**
Total External Borrowing	**140**
Other Long Term Liabilities:	
- PFI	34
- Finance Leases	2
Total Gross External Debt	**176**
Investments:	
Managed in-house	
- Fixed term deposits	10
- Monies on call	20
- Money market funds	31
Total Investments	**61**

Appendix 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 local authority should ensure that the net external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional increases to the capital financing requirement for the current and next two financial years.

The Director of Resources reports that the Council has 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:

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 and in the case of the HRA, housing rent levels.

Capital Expenditure	**2011-12 Approved £m**	**2011-12 Revised £m**	**2012-13 Estimate £m**	**2013-14 Estimate £m**	**2014-15 Estimate £m**
Non-HRA	108.291	85.037	102.369	87.821	79.313
HRA	4.629	5.548	7.200	10.300	14.000
Total	**112.920**	**90.585**	**109.569**	**98.121**	**93.313**

3.2 Capital expenditure will be financed or funded as follows:

Capital Financing	**2011-12 Approved** **£m**	**2011-12 Revised** **£m**	**2012-13 Estimate** **£m**	**2013-14 Estimate** **£m**	**2014-15 Estimate** **£m**
Capital receipts	26.163	15.118	10.497	10.497	10.497
Government Grants	51.386	48.728	57.311	39.368	30.580
Major Repairs Allowance	3.500	3.500	3.500	3.500	3.500
Revenue contributions	4.311	5.057	6.100	9.200	12.900
Total Financing	85.360	72.403	77.408	62.565	57.477
Supported borrowing	-	-	-	-	-
Unsupported borrowing	27.560	18.182	32.161	35.556	35.836
Total Funding	27.560	18.182	32.161	35.556	34.315
Total Financing and Funding	**112.920**	**90.585**	**109.569**	**98.121**	**93.313**

4. Ratio of Financing Costs to Net Revenue Stream:

4.1 This is an indicator of affordability and highlights the on-going 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.

Ratio of Financing Costs to Net Revenue Stream	**2011/12 Approved** **%**	**2011/12 Revised** **%**	**2012/13 Estimate** **%**	**2013/14 Estimate** **%**	**2014/15 Estimate** **%**
Non-HRA	7.30%	7.98%	8.03%	8.49%	9.64%
HRA	n/a	2.11%	2.11%	2.12%	2.25%
Total	**7.30%**	**10.09%**	**10.15%**	**10.61%**	**11.89%**

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.

Capital Financing Requirement	2011-12 Approved £m	2011-12 Revised £m	2012-13 Estimate £m	2013-14 Estimate £m	2014-15 Estimate £m
Non-HRA	255	259	279	300	319
HRA	4	96	103	101	99
Total CFR	259	355	382	401	418

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.

Actual External Debt as at 31/03/2011	£m
Borrowing	142
Other Long-term Liabilities	34
Total	**176**

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 and Housing Rent levels. The incremental impact is calculated by comparing the total revenue budget requirement of the existing capital expenditure programme with an equivalent calculation of the revenue budget requirement arising following inclusion of the proposed capital programme for each of the next 3 years.

Incremental Impact of Capital Investment Decisions	2011-12 Revised £	2012-13 Estimate £	2013-14 Estimate £	2014-15 Estimate £
Increase in Band D Council Tax	14.25	27.93	29.10	28.07
Increase in Average Weekly Housing Rents	0.00	0.00	0.00	0.00

7.2 The increase in Band D council tax/average weekly rents reflects the increases in running costs and increases in the provision for capital financing charges of £3.394 million to undertake the amounts of borrowing detailed in the table in paragraph 3.2.

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 on a daily basis 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).

Authorised Limit for External Debt	2011-12 Approved £m	2011-12 Revised £m	2012-13 Estimate £m	2013-14 Estimate £m	2014-15 Estimate £m
Borrowing	266	346	355	375	395
Other Long-term Liabilities	35	35	37	35	33
Total	**301**	**381**	**392**	**410**	**428**

The 2011-12 approved authorised limit has been increased to reflect the amount of loans that the Council will need to raise in March 2012 as part of the reform to the council housing finance subsidy system. This increased limit is shown in the table above as the 2011-12 revised authorised limit. The raising of these loans was not included in the 2011-12 approved authorised limit because it was assumed these loans would be raised during the year 2012-13.

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 Director of Resources 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 full Council.

Operational Boundary for External Debt	2011-12 Approved £m	2011-12 Revised £m	2012-13 Estimate £m	2013-14 Estimate £m	2014-15 Estimate £m
Borrowing	214	294	304	325	345
Other Long-term Liabilities	35	35	37	35	33
Total	**249**	**329**	**341**	**360**	**378**

The 2011-12 approved operational boundary has also been increased to reflect the amount of loans that the Council will need to raise in March 2012 as part of the reform to the council housing finance subsidy system. This increased limit is shown in the table above as the 2011-12 revised operational boundary. The raising of these loans was not included in the 2011-12 approved operational boundary limit because it was assumed these loans would be raised during the year 2012-13.

9. Adoption of the CIPFA Treasury Management Code:

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

Adoption of the CIPFA Code of Practice in Treasury Management
The Council approved the adoption of the CIPFA Treasury Management Code at a meeting of Full Council on 26th February 2009.

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.

The Council will be deemed to be borrowing in advance of need if at any point in time the net amount of loans and other long term liabilities outstanding (ie the gross amount of loans and other long term liabilities outstanding less the amount of cash balances and investments) is greater than the Council's overall long term net borrowing requirement. This overall long term net borrowing requirement is equal to the Council's expected capital financing requirement at the end of the year less the expected level of reserves held at the end of the year.

Gross and Net Debt	2011-12 Estimated £m	2012-13 Authorised £m	2013-14 Authorised £m	2014-15 Authorised £m
Gross Debt	355	382	401	418
Less: Investments	(86)	(86)	(82)	(81)
Net Debt	**269**	**296**	**319**	**337**

11. HRA Limit on Indebtedness

11.1 This indicator places an upper limit on the amount of debt that the HRA can take on (ie it sets an upper limit on the HRA capital financing requirement).

11.2 This limit is set equal to the indicative cap level set by the CLG as part of the reform of the council housing finance subsidy system.

	2011-12 Revised £m	2012-13 Estimate £m	2013-14 Estimate £m	2014-15 Estimate £m
HRA Limit on Indebtedness	107.33	107.33	107.33	107.33

12. Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure:

12.1 These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. This Council calculates these limits on net principal outstanding sums. i.e. fixed rate debt net of fixed rate investments

12.2 The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises which could adversely impact on the revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments

Interest Rate Exposures	Existing level at 31/03/11 £m	2011-12 Approved £m	2011-12 Revised £m	2012-13 Estimate £m	2013-14 Estimate £m	2014-15 Estimate £m
Fixed						
Upper Limit for Fixed Interest Rate Exposure on Debt	119	214	214	197	205	229
Lower Limit for Fixed Interest Rate Exposure on Investments	(0)	(0)	(0)	(0)	(0)	(0)
Net Fixed Exposure	**119**	**214**	214	197	205	229
Variable						
Lower Limit for Variable Interest Rate Exposure on Debt	22	12	12	12	12	17
Upper Limit for Variable Interest Rate Exposure on Investments	(106)	(195)	(195)	(161)	(174)	(199)
Net Variable Exposure	**(84)**	**(183)**	(183)	(149)	(162)	(182)

11.3 The limits above provide the necessary flexibility within which decisions will be made for drawing down new loans on a fixed or variable rate basis; the decisions will ultimately be determined by expectations of anticipated interest rate movements as set out in the Council's treasury management strategy.

11.4 The negative amounts arise as a result of the Council's variable rate investments being substantially in excess of its variable rate borrowings.

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, in particular in the course of the next ten years.

12.2 It is calculated as the amount of projected fixed rate borrowing that matures in each period as a percentage of total projected fixed rate borrowing. 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 position at 31/03/11 %**	**Lower Limit for 2012-13 %**	**Upper Limit for 2012-13 %**
under 12 months	0%	0%	15%
12 months and within 24 months	0%	0%	15%
24 months and within 5 years	0%	0%	40%
5 years and within 10 years	6%	0%	50%
10 years and within 20 years	7%	0%	50%
20 years and within 30 years	33%	0%	65%
30 years and within 40 years	23%	0%	40%
40 years and within 50 years	30%	0%	50%
50 years and above	0%	0%	10%

13. Credit Risk:

13.1 The Council considers security first, then liquidity and finally yield when making investment decisions and / or placing deposits.

13.2 Credit ratings whilst remaining an important element of assessing credit risk, are not the only means by which the Council assesses counterparty credit risk.

13.3 Other information used by the Council in assessing counterparty credit risk include alternative assessments of credit strength (ie credit default swap rates), information on corporate developments, ~~of~~ and market sentiment towards counterparties (including share price and share price movements). The key indicators used include

- Published credit ratings of the financial institution (minimum A- or equivalent) and its sovereign (minimum AA+ or equivalent for non-UK sovereigns);
- Sovereign (ie Government) 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, markets sentiment and momentum;
- Subjective overlay (common sense).

13.4 The only indicators with prescriptive values are credit ratings. The other indicators of creditworthiness, which are more subjective in nature, 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 the early repayment of the monies invested.

Upper Limit for total principal sums invested over 364 days	**2011-12 Approved £m**	**2011-12 Revised £m**	**2012-13 Estimate £m**	**2013-14 Estimate £m**	**2014-15 Estimate £m**
	15	**15**	**20**	**25**	**25**

Appendix C – Economic & Interest Rate Forecast (Sections 4.1 & 5.1)

	Mar-12	Sep-12	Mar-13	Sep-13	Mar-14	Sep-14
UK bank rate						
Upside risk	-	-	0.25%	0.50%	0.50%	0.50%
Central case	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
Downside risk	-	-	-	-	-	-
1 year rate						
Upside risk	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
Central case	1.75%	1.75%	1.80%	1.95%	2.10%	2.30%
Downside risk	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%
5 year gilt yield						
Upside risk	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
Central case	1.30%	1.40%	1.60%	1.80%	2.10%	2.40%
Downside risk	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%
10 year gilt yield						
Upside risk	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
Central case	2.30%	1.45%	2.55%	2.70%	2.80%	2.90%
Downside risk	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%
20 year gilt yield						
Upside risk	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
Central case	3.05%	3.10%	3.25%	3.35%	3.45%	3.60%
Downside risk	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%
50 year yield						
Upside risk	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
Central case	3.40%	3.60%	3.80%	4.00%	4.00%	4.20%
Downside risk	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%

NOTE:
The rate of interest payable on new PWLB loans is equal to the yield on an equivalent length gilt plus 1%.

Consequently were the Council to raise a new 20 year PWLB loan in March 2012 it could, on average, expect to pay interest at a rate of 4.05% (ie 3.05% + 1%). The Council should however not be surprised if the rate of interest payable rate of interest payable lay anywhere in the range 3.80% (ie 3.05% + 1% - 0.25%) to 4.30%(ie 3.05% + 1% + 0.25%).

- Signs of economic growth in the developed economies of the world is difficult to find
- Conventional monetary policy (ie reductions in a country's base rate) has become largely redundant for the time being; the Bank of England and the US Federal Reserve (the US equivalent of the Bank of England) have signalled that their respective official interest rates will be on hold through to the end of 2012. The Council's treasury management advisers think that it could be 2016 before UK official interest rates rise from their current level of 0.5%.
- The Bank of England's Monetary Policy Committee unanimously agreed a return to unconventional monetary policy and has embarked on a further round (£75 billion) of Quantitative Easing (QE) ie the purchasing of UK Government bonds. There is a possibility that the existing round of £75 billion may be increased further in the early months of 2012.
- UK Government bonds are currently seen, by investors, as a safe haven. This 'safe haven' status is helping gilt yields low as a result of the high demand for UK Government bonds helping push up their price.
- The financial markets remain in a highly stressed state. The volume of lending between banks has fallen. As a consequence the rate of interest banks have to pay to borrow from each other has risen significantly. These conditions are not dissimilar to those seen at the time of the 2008 financial crisis.
- The scale of the debt problems within the eurozone area is likely to mean that the rate of economic growth in the euro area will remain low for several years into the future. This is likely to be the case even if a credible and achievable plan is established to resolve the crisis.
- The potential for the problems in the eurozone to adversely impact on the rest of the world economies remains high.
- The MPC's unanimous decision to embark on a further £75 billion of QE – demonstrates the concerns over the fragility of the UK economic recovery. For economic growth to occur somebody needs to be spending.
- Inflation remains high and well above the target rate of 2%. Energy prices, and the increase in VAT, continue to be the primary causes although the markets are now less concerned with inflation given the slim prospects of economic growth. The Bank of England's inflation forecasts still point to a sharp downturn in inflation during 2012 as the effects of increases in VAT and energy prices drop out of the annual calculation.
- Business confidence has yet to recover sufficiently for businesses to commit to new capital investment and increased employment levels. Unemployment remains very high and acts as a significant drag on consumption.
- UK economic growth in the period July to September was weak but positive (0.6%). The rate of growth in the quarters October to December and January to March are unlikely to be as strong and could well be significantly lower.
- Public finances are unlikely to meet the Coalition's initial target. Eliminating the UK's budget deficit will now take longer than initially thought and will not be complete until after the end of the current Parliament.

Appendix D – Recommended Sovereign and Counterparty List (Section 8)

Instrument	**Country/ Domicile**	**Counterparty (Group)**	**Maximum Counterparty Limit £m**	**Maximum Group Limit £m**
Term Deposits / CDs / Call Accounts	UK	Santander UK Plc (Banco Santander Group)	20	n/a
Term Deposits / CDs / Call Accounts	UK	Bank of Scotland Lloyds TSB (Lloyds Banking Group)	20 20	20
Term Deposits / CDs / Call Accounts	UK	Barclays Bank Plc	20	n/a
Term Deposits / CDs / Call Accounts	UK	HSBC Bank Plc	20	n/a
Term Deposits / CDs / Call Accounts	UK	Nationwide Building Society	20	n/a
Term Deposits / CDs / Call Accounts	UK	NatWest Royal Bank of Scotland (RBS Group)	20 20	20
Term Deposits	UK	UK Local Authority UK Local Authority Pension Fund	10 10	none

**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.