

TELFORD & WREKIN COUNCIL

**CABINET – 20 FEBRUARY 2014
COUNCIL – 27 FEBRUARY 2014**

2014/15 TREASURY STRATEGY AND TREASURY UPDATE REPORT

**REPORT OF THE CHIEF FINANCE OFFICER (ASSISTANT DIRECTOR: FINANCE,
AUDIT & INFORMATION GOVERNANCE)**

LEAD CABINET MEMBER – CLLR BILL McCLEMENTS

PART A – SUMMARY REPORT

1. SUMMARY OF MAIN PROPOSALS

The report updates members on Treasury Management activities during 2013/14 and details the Treasury Strategy recommended to be adopted for 2014/15

2013/14 Treasury Management Update

The treasury portfolio at the end of December showed overall net indebtedness of £102.8m (borrowing: £142.6m less investments: £39.8m). Base rates have remained at 0.5% all year with the next move expected to be upwards but not for some time, perhaps until 2016/17.

The borrowing strategy for 2013/14 is to use maturing investments to reduce borrowing where possible. To date, two PWLB loans have matured and no new loans have been taken out. Short term borrowing has been used to fund short term cash flow requirements.

The investment strategy for 2013/14 is to gain maximum benefit with security of principal sum invested being the primary consideration. The weighted average return on internal investments at the end of December 2013 was 3.31% compared to a benchmark return for the period of 0.42%. This is an outstanding over-achievement against benchmark and reflects decisions taken some years ago to place investment funds in longer-term fixed rate investments when interest rates were considerably higher than they are today. A schedule of investments is shown at Appendix F.

TREASURY STRATEGY

The Council's Treasury Management Strategy is set within the parameters of the relevant statute, guidance and accounting standards which include the Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services and the Prudential Code.

The Council is currently expected to be required to borrow up to £1.0m in 2014/15 based on the current capital programme plans and will adopt a flexible approach to borrowing. The borrowing requirement may increase if the Council proceeds with large commercial projects for example investment in a solar farm or housing for rent at commercial rent levels. In consultation with its treasury management advisors consideration will be given to affordability, maturity profile of existing debt, interest rate and refinancing risk as well as borrowing source.

Where possible, maturing investments will be used to reduce the level of additional borrowing which will reduce investment exposure going forward. The strategy for any new investments will be to lengthen investment periods, where cash flow permits, to achieve higher interest rates within acceptable risk parameters. Maximum investment levels with counterparties will be set to ensure prudent diversification is achieved.

The report also includes the Council's Minimum Revenue Provision Statement, which although the policy is unchanged from 2013/14, within the existing policy we are amending how we calculate the provision from straight line to an annuity basis. This is allowed within the guidance and we have discussed our proposals with our auditors and they have agreed our approach. This includes backdating of the adjustments back to the start of the prudential regime. This will produce a one off saving in 2013/14 of £4.884m and savings in 2014/15 of £1.489m, 2015/16 £1.232m, 2016/17 £1.084m and 2017/18 £0.921m, these gradually reduce before ultimately becoming a cost. If a net present value calculation is done to the cashflows then for a £10 million investment over 40 years using the government's green book discount rate, then the annuity cashflow is around £1 million lower. This change and saving reflects the time value of money. It also sets the Prudential Indicators associated with Treasury for 2014/15.

2. **RECOMMENDATIONS**

Members are asked to note the treasury management activities for the first half year, note the Treasury Management Policy Statement (Appendix A) and approve the Treasury Strategy, including the Annual Investment Strategy for 2014/15 together with the associated treasury Prudential Indicators and the Minimum Revenue Provision Statement.

3. **SUMMARY IMPACT ASSESSMENT**

COMMUNITY IMPACT Do these proposals contribute to specific priority plan objectives?

Yes/No Maximisation of investment income whilst managing risks and minimising borrowing costs whilst also managing risks helps to support the council's overall financial position and therefore the delivery of all policy objectives.

Will the proposals impact on specific groups of people?

Yes/No

TARGET COMPLETION / DELIVERY DATE

Part of ongoing Treasury Management Activities within the Treasury Management Strategy and Policy approved by Council.

FINANCIAL/VALUE FOR MONEY IMPACT

Yes/No Where appropriate these are detailed in the body of the report.

LEGAL ISSUES

Yes/No The Council's Treasury Strategy has to comply with the relevant statute, codes and guidance which are set out both in the main body of this report and Appendices A and C

of the strategy itself Attached).

The Assistant Director: Finance, Audit & Information Governance (Section 151 Officer) has responsibility for the administration of the financial affairs of the Council. In providing this report the Assistant Director: Finance, Audit & Information Governance is meeting one of the responsibilities of the post contained within the Council's Constitution at Part 2, Article 12, paragraph 12.04(f) which states "The Chief financial Officer will contribute to the promotion and maintenance of high standards of governance, audit, probity and propriety, risk management and the approval of the statement of accounts through provision of support to the Audit Committee."

**OTHER IMPACTS,
RISKS AND
OPPORTUNITIES**

Yes/No

The key opportunities and risks associated with treasury management activities are set out in the body of the report and in the Treasury Management Strategy and Policy approved by Council and will be regularly monitored throughout the year.

**IMPACT ON
SPECIFIC WARDS**

Yes/No

PART B – ADDITIONAL INFORMATION

4. 13/14 TREASURY MANAGEMENT UPDATE

4.1 CURRENT PORTFOLIO POSITION

	31 March 13	31 Dec 13
	Principal	Principal
	£m	£m
Fixed Rate Borrowing - PWLB	50.522	40.022
Fixed Rate Borrowing - LOBO	60.000	60.000
Variable Rate Borrowing - LOBO/market	<u>0.092</u>	<u>42.570</u>
Total Debt	110.614	142.592
Investments - in-house	<u>31.426</u>	<u>39.829</u>
Total Investments	31.426	39.829
Net Indebtedness	79.188	102.763

4.2 INTEREST RATES

Base rates began the year at 0.5% and have remained unchanged all year. The Bank of England Quantitative Easing programme remained at £375bn. The next move in the base rate is expected to be upwards, but not for some time, perhaps not until 2016 and will be strongly linked to the recovery of the economy.

4.3 BORROWING & RESCHEDULING

The borrowing strategy for the current year has been to use maturing investments to reduce borrowing where possible.

Rescheduling

During 2013/14 no rescheduling has taken place as market conditions have not been favourable, however the scope for opportunities is regularly monitored.

New Borrowing

During the year 2 PWLB loans matured in November for £5m each.

Between the period 1 June 2013 (previous Member update) and 31 December 2013, £60.6m of temporary loans have been raised in order to fund short-term cash flow requirements at various points. Interest rates have ranged from 0.27% to 0.40% - interest rates have remained fairly low during this time. £42.6m of this temporary borrowing was outstanding at 31 December 2013.

4.4 INVESTMENTS

The strategy for the current year is: To gain maximum benefit, subject to risk control parameters, whilst achieving as a minimum target the 7 day deposit

rate.

4.4.1 In-House Investments

The majority of the Council's investments are internally managed - a mix of both temporary investments for cash flow purposes and longer term investments are undertaken internally. The target return is to achieve at least the 7 day deposit rate.

Temporary Investments

A proportion of funds are invested by the Council's own officers in order to maximise returns from day to day cash flows

In total £1,064m of investments were placed between 1 June and 31 December. Interest rates have ranged from 0.35% to 0.80% and periods ranged from overnight deposits to 52 days. £39.829m in house temporary investments were held at 31 December 2013.

Longer Term Investments

A number of internally managed deposits have been made previously. This has not been added to during 2013/14 and one investment has matured so far during the year for £5.0m. A full list of longer term investments is shown below and total £20.0m.

		£m	%
Fixed Deposit	03/08/09 – 01/08/14	5.0	6.32
Fixed Deposit	06/03/09 – 06/03/14	5.0	6.31
Fixed Deposit	31/03/09 – 31/03/14	5.0	6.37
Fixed Deposit	22/04/09 – 22/04/14	5.0	6.35
Total		20.0	

It should be noted that under the current guidance from our Treasury Advisors our investment policy would mean that new investments should not be placed for longer than 12 months. However the majority of these investments were placed before the start of the financial crisis which resulted in recommended periods for maximum duration being shortened considerably. The council is benefiting from very attractive rates of interest that are no longer available as a result of the decisions to place these investments for longer term periods when interest rates were considerably higher, but these all now mature within the next 7 months.

Overall the weighted average return on all internal investments for the year to date was 3.31% compared to a benchmark return for the period of 0.42%.

4.4.2 Overall Position and Exposure

A full analysis of all Council investments at the end of December is shown in Appendix F.

Our current counterparty limit and maximum exposure is £20.0m with any one counterparty. Counterparty limits will be reviewed once our long term investments have matured during 2014. At the end of December the greatest exposure with a single counterparty was £20.0m with Barclays (50% of the total portfolio).

No investments in Supranational Bonds were held at the end of December.

The Council is guided by its Treasury advisers, Arlingclose, in assessing investments.

4.5 LEASING

Each year the Council arranges operating and finance leases for assets such as vehicles, computers and equipment. This helps to spread the cost over a number of years.

The first drawdown for 2013/14 was completed in October. The drawdown from JCB Finance totalled £0.017m and funded the purchase of equipment over five years at an interest rate of 1.8%. A further lease drawdown is anticipated in March.

5. TREASURY STRATEGY FOR 2014/15 to 2016/17

5.1 BACKGROUND

5.1.1 The CIPFA Treasury Management Code of Practice

The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") and the Prudential Code require local authorities to determine the Treasury Management Strategy Statement (TMSS) and Prudential Indicators on an annual basis. The TMSS also incorporates the Annual Investment Strategy as required under the CLG's Investment Guidance.

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

- Treasury Management Strategy for 2014/15
- Annual Investment Strategy for 2014/15
- Prudential Indicators for 2014/15, 2015/16, 2016/17 and 2017/18
- MRP Statement.

Treasury Management is about the management of risk. The Authority is responsible for its treasury decisions and activity. No treasury management activity is without risk.

As per the requirements of the Prudential Code, the Authority has adopted the CIPFA Treasury Management in Public Services at a meeting of Full Council on 4 March 2010. In addition, the Department for Communities and Local Government (CLG) issued revised Guidance on Local Authority Investments in March 2010 that requires the Authority to approve an investment strategy before the start of each financial year.

This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the CLG Guidance.

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

The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification,

monitoring and control of risk are therefore central to the Authority's treasury management strategy.

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

5.1.2 External Context

Economic background: The Bank of England's Monetary Policy Committee (MPC) through its recent forward guidance is committed to keeping policy rates low for an extended period using the Labour Force Survey unemployment rate of 7% as a threshold for when it would consider whether or not to raise interest rates, subject to certain knock-outs. Unemployment was 7.7% in August 2013, but has now fallen to 7.1% just above the threshold. It is not anticipated that there will be any increase in the base rate as a result of this in the short term. The Bank of England may even reduce this threshold to 6.5% or choose a different measure.

The flow of credit to households and businesses is slowly improving but is still below pre-crisis levels. The fall in consumer price inflation from the high of 5.2% in September 2011 to 2.0% in December 2013 will allow real wage increases (i.e. after inflation) to slowly turn positive and aid consumer spending.

Stronger growth data in 2013 (0.4% in Q1, 0.7% in Q2, 0.8% in Q3 and 0.7% in Q4) alongside a pick-up in property prices mainly stoked by government initiatives to boost mortgage lending have led markets to price in an earlier rise in rates than warranted under Forward Guidance and the broader economic backdrop. However, with jobs growth picking up slowly, many employees working shorter hours than they would like and benefit cuts set to gather pace, growth is likely to only be gradual. Arlingclose forecasts the MPC will maintain its resolve to keep interest rates low until the recovery is convincing and sustainable.

In the US expectations for the slowing in the pace of asset purchases ('tapering') by the Federal Reserve and the end of further asset purchases will remain predominant drivers of the financial markets. The Fed did not taper in September and has talked down potential tapering in the near term. It now looks more likely to occur in early 2014 which will be supportive of bond and equity markets in the interim.

Credit outlook: The credit risk of banking failures has diminished, but not dissipated altogether. Regulatory changes are afoot in the UK, US and Europe to move away from the bank bail-outs of previous years to bank resolution regimes in which shareholders, bond holders and unsecured creditors are 'bailed in' to participate in any recovery process. This is already manifest in relation to holders of subordinated debt issued by the Co-op which will suffer a haircut on its conversion bail-in to alternative securities and/or equity. There are also proposals for EU regulatory reforms to Money Market Funds which will, in all probability, result in these funds moving to a VNAV (variable net asset value) basis and losing their 'triple-A' credit rating wrapper. Diversification of investments between creditworthy counterparties to mitigate bail in risk will become even more important in the light of these developments.

Interest rate forecast: Arlingclose's forecast is for the Bank Rate to remain flat until late 2016, the risk to the upside (i.e. rates being higher) are weighted more heavily towards the end of the forecast horizon, as the table below shows. Gilt yields are expected to rise over the forecast period with medium- and long-dated gilts expected to rise by between 0.7% and 1.1%. A more detailed economic and interest rate forecast provided by the Authority's treasury management advisor is attached at Appendix D.

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 2.5% for 2014/15, 3.25% for 2015/16 and 4.5% for 2016/17 onwards, and that new longer term loans will be borrowed at the same average rates.

5.1.3 Local Context

The Authority's current level of debt and investments is set out at Appendix B.

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 Authority's Treasury Management activities.

The Authority is able to borrow funds in excess of the current level of its CFR up to the projected level in 2017/18. The Authority is likely to only borrow in advance of need if it felt the benefits of borrowing at interest rates now compared to where they are expected to be in the future, outweighs the current cost and risks associated with investing the proceeds until the borrowing was actually required.

The forecasted movement in the CFR in coming years is one of the Prudential Indicators (PIs). The movement in actual external debt and usable reserves combine to identify the Authority's borrowing requirement and potential investment strategy in the current and future years.

The estimates, based on the current Revenue Budget and Capital Programmes, are:

	31/03/13 Actual £m	31/03/14 Estimate £m	31/03/15 Estimate £m	31/03/16 Estimate £m	31/03/17 Estimate £m
Capital Financing Requirement	241.957	275.699	270.329	258.250	248.247
Less: Other long term liabilities (e.g. PFI)	-61.924	-61.742	-60.432	-58.756	-57.605
Borrowing CFR	180.033	213.957	209.897	199.494	190.642
Less: External Borrowing	-110.614	-142.304	-133.266	-127.046	-122.866
Internal Borrowing	69.419	71.653	76.631	72.448	67.776
Less: Usable reserves	-49.116	-49.116	-49.116	-49.116	-49.116
Less: Working capital	-53.879	-32.537	-27.515	-23.332	-18.660
Investments	33.576	10.000	0.000	0.000	0.000

The table above shows a falling Capital Financing Requirement from 2014/15 onwards and this combined with maturing investments reduces the need to borrow other than replacing maturing borrowing and converting from temporary borrowing to fixed borrowing at the best time for the Council dependent on market conditions.

5.1.4 Borrowing Strategy

The Authority currently holds £142.592 million of loans, an increase of £31.978 million on the previous year, as part of its strategy for funding previous years' capital programmes. The Council also holds £61.742 million of other longer term liabilities (mainly PFI). The balance sheet forecast in the above table shows that the Authority expects borrowing to be maintained at around this level at year end and then fall over the next few years as capital receipts are realised. The Authority may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £234 million.

The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.

Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. Whilst such a strategy is most likely to be beneficial over the next 2-3 years as official interest rates remain low, it is unlikely to be sustained in the medium-term. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2014/15 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

In addition, the Authority may borrow short-term loans to cover unexpected cash flow shortages.

The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board
- UK local authorities, including Fire and police Authorities
- any institution approved for investments (see below)
- any other bank or building society authorised by the Prudential Regulation Authority to operate in the UK
- UK public and private sector pension funds
- capital market bond investors
- special purpose companies created to enable joint local authority bond issues.

The Authority has previously raised a significant part of its long-term borrowing from the Public Works Loan Board, but it continues to investigate other sources of finance, such as local authority loans and bank loans, that may be available at more favourable rates.

The Authority holds £60m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. £55m of these LOBOS have options during 2014/15, and although the Authority understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk, which will arise at some point in the future when interest rates increase. The Authority will take the option to repay LOBO loans at no cost if it has the opportunity to do so. Total borrowing via LOBO loans will be limited to £60m. Short-term and variable rate loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

Debt Rescheduling: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Some bank lenders may also be prepared to negotiate premature redemption terms. The Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall saving or reduction in risk. Treasury management and borrowing strategies in particular continue to be influenced not only by the absolute level of borrowing rates but also the relationship between short and long term interest rates. The interest rate forecast provided in Appendix D indicates that an acute difference between short and longer term interest rates is expected to continue. This difference creates a "cost of carry" for any new longer term borrowing where the proceeds are temporarily held as investments because of the difference between what is paid on the borrowing and what is earned on the investment. Whilst the cost of carry can be assumed to be a reasonably short-term issue since borrowing is often for longer dated periods (anything up to 50 years) it cannot be ignored against a backdrop of uncertainty and affordability constraints in the Authority's wider financial position.

5.2 Investment Strategy

The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has ranged between £31 million and £72 million, and levels are expected to reduce in the forthcoming year as long term investments mature and are used to avoid/reduce borrowing.

Both the CIPFA Code and the CLG Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

The Authority may invest its surplus funds with any of the counterparties in table 2 below, subject to the cash and time limits shown.

Approved Investment Counterparties

Counterparty		Cash limit	Time limit †
Banks and other organisations and securities whose lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's is:	AAA	£20m each	10 years*
	AA+		5 years*
	AA		4 years*
	AA-		3 years*
	A+		2 years
	A		1 year
	A-		
UK Central Government (irrespective of credit rating)		unlimited	50 years**
UK Local Authorities (irrespective of credit rating)		£20m each	50 years**
UK Registered Providers of Social Housing whose lowest published long-term credit rating is A- or higher		£20m each	10 years**
UK Registered Providers of Social Housing whose lowest published long-term credit rating is BBB- or higher and those without credit ratings		£5m each	5 years
UK Building Societies without credit ratings		£1m each	1 year
Money market funds and other pooled funds		£10m each	n/a
Any other organisation, subject to an external credit assessment and specific advice from the Authority's treasury management adviser		£5m each	3 months
		£1m each	1 year
		£100k each	5 years

† the time limit is doubled for investments that are secured on the borrower's assets

* but no longer than 2 years in fixed-term deposits and other illiquid instruments

** but no longer than 5 years in fixed-term deposits and other illiquid instruments

There is no intention to restrict investments to bank deposits, and investments may be made with any public or private sector organisations that meet the above credit rating criteria. This reflects a lower likelihood that the UK and other governments will support failing banks as the bail-in provisions in the Banking Reform Act 2014 and the EU Bank Recovery and Resolution Directive are implemented.

In addition, the Authority may invest with organisations and pooled funds without credit ratings, following an external credit assessment and advice from the Authority's treasury management adviser.

Current Account Bank: Following a competitive tender exercise held in 2010, the Authority's current accounts are held with HSBC plc which is currently rated above the minimum A- rating in table 2. Should the credit ratings fall below A-, the Authority may continue to deposit surplus cash with HSBC plc providing that investments that can be withdrawn on the next working day, and that the bank maintains a credit rating no lower than BBB- (the lowest investment grade rating).

Registered Providers: Formerly known as Housing Associations, Registered Providers of Social Housing are tightly regulated by the Homes and Communities Agency and retain a high likelihood of receiving government support if needed. The Authority will consider investing with unrated Registered Providers with adequate credit safeguards, subject to receiving independent advice.

Building Societies: The Authority takes additional comfort from the building societies' regulatory framework and insolvency regime where, in the unlikely event of a building society liquidation, the Authority's deposits would be paid out in preference to retail depositors. The Authority will therefore consider investing with unrated building societies where independent credit analysis shows them to be suitably creditworthy. The Government has announced plans to amend the building society insolvency regime alongside its plans for wide ranging banking reform, and investments in lower rated and unrated building societies will therefore be kept under continuous review.

Money Market Funds: These funds are pooled investment vehicles consisting of money market deposits and similar instruments. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager. Fees of between 0.10% and 0.20% per annum are deducted from the interest paid to the Authority. Funds that offer same-day liquidity and aim for a constant net asset value will be used as an alternative to instant access bank accounts, while funds whose value changes with market prices and/or have a notice period will be used for longer investment periods. Note: we have removed the requirement for AAA ratings following EU proposals to stop money market funds from having credit ratings.

Other Organisations: The Authority may also invest cash with other organisations, for example by making loans to small businesses. Because of the higher perceived risk of unrated businesses, such investments may provide considerably higher rates of return. They will however only be made following a favourable external credit assessment and on the specific advice of the Authority's treasury management adviser.

Risk Assessment and Credit Ratings: The Authority uses long-term credit ratings from the three main rating agencies Fitch Ratings, Moody's Investors Service and Standard & Poor's Financial Services to assess the risk of investment default. The lowest available counterparty credit rating will be used to determine credit quality, unless an investment-specific rating is available. Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a A- rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other Information on the Security of Investments: The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating

criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

Specified Investments: The CLG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
 - o the UK Government,
 - o a UK local authority, parish council or community council, or
 - o a body or investment scheme of "high credit quality".

The Authority defines "high credit quality" organisations as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

Non-specified Investments: Any investment not meeting the definition of a specified investment is classed as non-specified. The Authority defines "high credit quality" organisations as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. The Authority does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in the table below.

Table 3: Non-Specified Investment Limits

	Cash limit
Total long-term investments	£25m
Total investments without credit ratings or rated below A-	£5m
Total investments in foreign countries rated below AA+	£5m
Total non-specified investments	£30m

Investment Limits: The Authority has revenue reserves, which could be used to cover investment losses and are forecast to be £49 million on 31st March 2014 although not all of these are available though. In order that no more than 50% of

reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £20 million. A group of banks under the same ownership or a group of funds under the same management will be treated as a single organisation for limit purposes. Limits will also be placed on investments in brokers' nominee accounts (e.g. King & Shaxson), foreign countries and industry sectors as below:

Table 4: Investment Limits

	Cash limit
Any single organisation, except the UK Central Government	£20m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£20m per group
Any group of pooled funds under the same management	£20m per manager
Negotiable instruments held in a broker's nominee account	£20m per broker
Foreign countries	£10m per country
Registered Providers	£10m in total
Building Societies	£10m in total
Loans to small businesses	£5m in total
Money Market Funds	£10m in total

Approved Instruments: The Authority may lend or invest money using any of the following instruments:

- interest-bearing bank accounts,
- fixed term deposits and loans,
- callable deposits and loans where the Authority may demand repayment at any time (with or without notice),
- callable deposits and loans where the borrower may repay before maturity, but subject to a maximum of £5 million in total,
- certificates of deposit,
- bonds, notes, bills, commercial paper and other marketable instruments, and
- shares in money market funds and other pooled funds.

Investments may be made at either a fixed rate of interest, or at a variable rate linked to a market interest rate, such as LIBOR, subject to the limits on interest rate exposures below.

Liquidity management: The Authority uses cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a pessimistic basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium term financial plan and cash flow forecast.

5.3 Ethical Investment

The Council will not knowingly directly invest in organisations whose activities

include practices which directly pose a risk of serious harm to individuals or groups, or whose activities are inconsistent with the mission and values of the Council. At the same time the Council will take full responsibility for proper management of risk and safeguarding its investments by ensuring that they are diversified and made with organisations suitably credit assessed.

The Council's lending activity will be subject to (in order of rank)

- The assessment of meeting the minimum lending criteria as specified in the current Treasury Management Strategy and the minimum credit ratings as outlined in the Strategy;
- Meeting the Security, Liquidity & Yield criteria as set out in the current Treasury Management Strategy and Compliance with the Treasury Management Practice Statements;
- And investments are not contrary to the values outlined in the Ethical Investment Framework.

5.4 The Use of Financial Instruments for the Management of Risks

Policy on Use of Financial Derivatives: Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Authority will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

5.5 Balanced Budget Requirement

The Authority complies with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget.

5.6 2014/15 MRP Statement

5.6.1 The Local Authorities (Capital Finance and Accounting)(England)(Amendment) Regulations 08 (SI 08/414) place a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Secretary of State and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

5.6.2 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.

- 5.6.3** MRP in 2014/15: 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 Council chooses).
- 5.6.4** The MRP Statement will be submitted to Council before the start of the 2014/15 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 Council at that time.
- 5.6.5** The Council will apply Option 1 in respect of supported capital expenditure and Option 3 in respect of unsupported capital expenditure.

There is a change to how MRP will be calculated under option 3 and rather than using a straight line basis MRP will be calculated on an annuity method as allowed within the guidance. This will be applied to the calculation of MRP for 2013/14 and ongoing, as well as a one off adjustment during 2013/14 in relation to voluntary overprovision of MRP in previous years since the introduction of the prudential system. The value of this over provision is a one off adjustment of £4.884m and this will be used to offset some of the costs in relation to the additional capital investments included in the budget over the next 10 years. Savings in MRP will also accrue in 2014/15 for £1.489m; 2015/16 £1.232m; 2016/17 £1.084m and 2017/18 £0.921m. This saving will gradually reduce and eventually become a cost. The revised methodology reflects the time value of money.

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

5.7 Monitoring and Reporting on the Treasury Outturn and Prudential Indicators

The Assistant Director: Finance, Audit & Information Governance will report to the Audit Committee on treasury management activity / performance and Performance Indicators as follows:

- half yearly against the strategy approved for the year. The Authority will produce an outturn report on its treasury activity no later than 30th September after the financial year end.
- Audit Committee will be responsible for the scrutiny of treasury management activity and practices rather than the Budget and Finance Scrutiny Committee.

6 Other Items

6.1 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.
Reviewing and addressing training needs: The authority regularly reviews the training needs of its staff involved with treasury management and ensures that staff are appropriately trained.

6.2 Investment Consultants/Treasury Advisors

The Council uses Arlingclose as its external treasury management advisers.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review to ensure the quality of any such service is controlled.

7. BACKGROUND PAPERS

CIPFA Code of Practice for Treasury Management in Local Authorities
Temporary Borrowing Records
PWLB records
Investment records
Draft Treasury Strategy provided by Arlingclose
Local Government Act 2003
CLG Guidance on Local Authority Investments
Audit Commission – Risk and Return

Report prepared by
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(01952) 383100.

TREASURY MANAGEMENT POLICY STATEMENT

1. INTRODUCTION AND BACKGROUND

1.1 The Council adopts the key recommendations of CIPFA's Treasury Management in the Public Services: Code of Practice (the Code), as described in Section 5 of the Code.

1.2 Accordingly, the Council will create and maintain, as the cornerstones for effective treasury management:-

- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities
- Suitable treasury management practices (TMPs), setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

1.3 The Council will receive reports on its treasury management policies, practices and activities including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.

1.4 The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to Audit Committee and for the execution and administration of treasury management decisions to Assistant Director: Finance, Audit & Information Governance, who will act in accordance with the organisation's policy statement and TMPs and CIPFA's Standard of Professional Practice on Treasury Management.

1.5 The Council nominates Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

2. POLICIES AND OBJECTIVES OF TREASURY MANAGEMENT ACTIVITIES

2.1 The Council defines its treasury management activities as:

"The management of the Council'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."

2.2 This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

2.3 This Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management."

2.4 The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken and the type of borrowing should allow the Council

transparency and control over its debt. The Council will look to minimise borrowing through the use of maturing investments to fund capital expenditure rather than reinvestment.

2.5 The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Authority's investments followed by the yield earned on investments remain important but are secondary considerations. Generally as investments mature they will not be reinvested but be used to minimise borrowing.

APPENDIX B

EXISTING PORTFOLIO PROJECTED FORWARD

	Current Portfolio £m	%	31/3/14 Estimate £m	31/3/15 Estimate £m	31/3/16 Estimate £m	31/3/17 Estimate £m	31/3/18 Estimate £m
External Borrowing:							
Fixed Rate – PWLB	40.0	20	39.5	28.5	27.5	26.5	25.5
Fixed Rate – Market	60.0	29	60.0	60.0	60.0	60.0	60.0
Variable Rate – PWLB	0.0	0	0.0	0.0	0.0	0.0	0.0
Variable Rate – Market	42.6	21	42.8	44.8	39.6	36.4	33.7
Total External Borrowing	142.6	70	142.3	133.3	127.1	122.9	119.2
IFRS Long Term Liabilities:							
PFI	61.0	30	61.0	59.7	58.0	56.9	57.3
Finance Leases	0.7	0	0.7	0.7	0.7	0.7	0.7
Total Gross External Debt	204.3	100	204.0	193.7	185.8	180.5	177.2
Investments: <i>Managed in-house</i>							
Short-term monies (Deposits/ monies on call /MMFs)	39.8	100	10.0	0.0	0.0	0.0	0.0
Long-term investments (maturities over 12 months)	0.0	0	0.0	0.0	0.0	0.0	0.0
Total Investments	39.8	100	10.0	0.0	0.0	0.0	0.0
(Net Borrowing Position)/ Net Investment position	(164.5)		(194.0)	(193.7)	(185.8)	(180.5)	(177.2)

Appendix C
Prudential Indicators 2014/15 – 2017/18

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. Gross debt and the Capital Financing Requirement:

This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for a capital purpose, the local authority should ensure that debt 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 Assistant Director: Finance, Audit & Information Governance reports that the authority had no difficulty meeting this requirement in 2013/14, 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	13/14 Approved £m	13/14 Revised £m	14/15 Estimate £m	15/16 Estimate £m	16/17 Estimate £m	17/18 Estimate £m
Total	107.199	99.125	115.650	26.518	4.464	1.432

**if applicable*

3.2 Capital expenditure will be financed or funded as follows:

Capital Financing	13/14 Approved £m	13/14 Revised £m	14/15 Estimate £m	15/16 Estimate £m	16/17 Estimate £m	17/18 Estimate £m
Capital receipts	39.127	5.374	38.252	26.540	7.989	3.500
Government Grants	64.087	57.766	75.018	6.198	0.655	1.603
Revenue / External contributions	0.349	0.779	1.418	0.000	0.000	0.000
Total Financing	103.563	63.919	114.688	32.738	8.644	5.103
Supported borrowing	0.257	1.292	0.658	0.000	0.000	0.000
Unsupported borrowing	3.379	33.914	0.304	-6.220	-4.180	-3.671
Total Funding	3.636	35.206	0.962	-6.220	-4.180	-3.671
Total Financing and Funding	107.199	99.125	115.650	26.518	4.464	1.432

4. Ratio of Financing Costs to Net Revenue Stream:

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

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

Ratio of Financing Costs to Net Revenue Stream	13/14 Approved %	13/14 Revised %	14/15 Estimate %	15/16 Estimate %	16/17 Estimate %	17/18 Estimate %
Total	3.11	2.89	3.85	3.67	4.28	4.25

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	13/14 Approved £m	13/14 Revised £m	14/15 Estimate £m	15/16 Estimate £m	16/17 Estimate £m	17/18 Estimate £m
Total CFR	237.879	241.957	275.699	270.329	258.250	248.247

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 31/03/13	£m
Borrowing	110.614
Other Long-term Liabilities	61.924
Total	172.518

7. Incremental Impact of Capital Investment Decisions:

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

Incremental Impact of Capital Investment Decisions	13/14 Approved £	14/15 Estimate £	15/16 Estimate £	16/17 Estimate £	17/18 Estimate £m
Increase in Band B Council Tax	-3.71	21.21	4.20	2.51	12.64

7.2 The increase in Band B council tax reflects the increases in the provision for Capital Financing Charges of £0.599m by 2019/20 to undertake additional borrowing of £18.846m arising from the proposed capital programme. In the short term there are savings due to the rephasing of existing planned borrowing and medium term there is spending ahead of anticipated capital receipts, but once complete the overall increase in Band B is £10.51.

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	13/14 Approved £m	13/14 Revised £m	14/15 Estimate £m	15/16 Estimate £m	16/17 Estimate £m	17/18 Estimate £m
Borrowing	145	145	170	165	165	160
Other Long-term Liabilities	65	65	64	63	62	61
Total	210	210	234	228	227	221

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 Assistant Director: Finance, Audit & Information Governance 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 Audit Committee.

Operational Boundary for External Debt	13/14 Approved £m	13/14 Revised £m	14/15 Estimate £m	15/16 Estimate £m	16/17 Estimate £m	17/18 Estimate £m
Borrowing	125	125	158	149	150	141
Other Long-term Liabilities	63	63	62	61	60	59
Total	188	188	220	210	210	200

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 its Council meeting on 4 March 10.

The Council has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices.

10. Gross Debt and the Capital Finance Requirement

10.1 The purpose of this treasury indicator is to highlight a situation where the Council is planning to borrow in advance of need. If these figures exceed CFR (which they don't) they would indicate we are borrowing in advance of need.

Gross and Net Debt	13/14 Estimated £m	14/15 Authorised £m	15/16 Authorised £m	16/17 Authorised £m	17/18 Authorised £m
Outstanding Borrowing (at nominal value)	142.304	134.644	128.424	124.244	120.573
Other Long-term Liabilities (at nominal value)	61.742	60.432	58.756	57.605	58.042
Gross Debt	204.046	195.076	187.180	181.849	178.615

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

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

11.2 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

Guidance note on quantum of acceptable volatility...

	Existing level (or Benchmark level) at 31/03/13 %	13/14 Approved %	13/14 Revised %	14/15 Estimate %	15/16 Estimate %	16/17 Estimate %	17/18 Estimate %
Upper Limit for Fixed Interest Rate Exposure	100	100	100	100	100	100	100
Upper Limit for Variable Interest Rate Exposure	30	30	30	30	30	30	30
Local Indicator – Upper limit for net variable rate exposure. (Net principal re gross variable rate borrowing and investments divided by gross borrowing plus investments)	70	70	70	70	70	70	70

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.

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 borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

Maturity structure of fixed rate borrowing	Existing level (level at 31/03/13) %	Lower Limit for 14/15 %	Upper Limit for 14/15 %
under 12 months	30 (0)	0	40
12 months and within 24 months	8 (10)	0	25
24 months and within 5 years	2 (12)	0	50
5 years and within 10 years	2 (2)	0	75
10 years and within years	0 (0)	0	75
years and within 30 years	0 (0)	0	75
30 years and within 40 years	7 (5)	0	100
40 years and within 50 years	16 (25)	10	100
50 years and above	35 (45)	15	100

13. Credit Risk:

13.1 The Council considers security, liquidity and yield, in that order, when making investment decisions.

13.2 Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Council's assessment of counterparty credit risk.

13.3 The Council also considers alternative assessments of credit strength, and information on corporate developments of and market sentiment towards counterparties. The following key tools are used to assess credit risk:

- Published credit ratings of the financial institution (minimum A- or equivalent) and its sovereign (minimum AA+ or equivalent for non-UK sovereigns);
- Sovereign support mechanisms;
- Credit default swaps (where quoted);
- Share prices (where available);
- Economic fundamentals, such as a country's net debt as a percentage of its GDP);
- Corporate developments, news, articles, markets sentiment and momentum;
- Subjective overlay.

13.4 The only indicators with prescriptive values remain to be credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

14. Upper Limit for total principal sums invested over 364 days:

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

Upper Limit for total principal sums invested over 364 days	13/14 Approved £m	13/14 Revised £m	14/15 Estimate £m	15/16 Estimate £m	16/17 Estimate £m	17/18 Estimate £m
	95	95	95	95	95	95

Appendix D – Arlingclose Economic & Interest Rate Forecast December 2013

Underlying Assumptions:

- Underlying assumptions:
- Growth continues to strengthen with the second estimate for Q3 growth coming in at an unrevised 0.8% and first estimate of Q4 at 0.7%. The service sector remains the main driver of growth, boosted by a contribution from construction.
- The unemployment rate has fallen to 7.1%. The pace of decline in this measure will be dependent on a slower expansion of the workforce than the acceleration in the economy, alongside the extent of productivity.
- The CPI for December has fallen to 2.0%, a much more comfortable position for the MPC. Utility price increases are expected to keep CPI at or above the 2% target in 2014, before falling back again.
- The principal measure in the MPC's Forward Guidance on interest rates is the Labour Force Survey (LFS) unemployment rate. The MPC intends not to raise the Bank Rate from its current level of 0.5% at least until this rate has fallen to a threshold of 7%, this threshold is likely to be reviewed.
- The reduction in uncertainty and easing of credit conditions have begun to unlock demand, much of which has fed through to the housing market. In response to concerns over a house price bubble, the Bank of England announced a curtailment of the Funding for Lending Scheme, which will henceforth concentrate on business lending only.
- The MPC will not hesitate to use macro prudential and regulatory tools to deal with emerging risks (such as curtailing the FLS). Absent risks to either price stability or financial stability, the MPC will only tighten policy when it is convinced about the sustained durability of economic growth.
- Federal Reserve monetary policy expectations - the slowing in the pace of asset purchases ('tapering') and the end of further asset purchases - will remain predominant drivers of the financial markets. Tapering of asset purchases will begin in Q1 2014. The US political deadlock over the debt ceiling will need resolving in Q1 2014.
- The European backstop mechanisms have lowered the risks of catastrophic meltdown. The slightly more stable economic environment at the aggregate Eurozone level could be undone by political risks and uncertainty in Italy, Spain and Portugal (doubts over longevity of their coalitions). The ECB has discussed a third LTRO, as credit conditions remain challenging for European banks.
- China data has seen an improvement, easing markets fears. Chinese leaders have signalled possible monetary policy tightening.
- On-going regulatory reform and a focus on bail-in debt restructuring of is likely to prolong banking sector deleveraging and maintain the corporate credit bottleneck.

Forecast:

- Our projected path for short term interest rates remains flat. Markets are still pricing in an earlier rise in rates than warranted under Forward Guidance and the broader economic backdrop. The MPC will not raise rates until there is a sustained period of strong growth. However, upside risks weight more heavily at the end of our forecast horizon.
- We continue to project gilt yields on an upward path through the medium term. The recent climb in yields was overdone given the soft fundamental global outlook and risks surrounding the Eurozone, China and US.

	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16
Official Bank Rate													
Upside risk		0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	1.00
Arlingclose Central Case	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk				-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
3-month LIBID rate													
Upside risk	0.20	0.25	0.30	0.35	0.40	0.50	0.55	0.60	0.65	0.70	0.75	0.80	0.80
Arlingclose Central Case	0.45	0.45	0.50	0.55	0.55	0.55	0.55	0.60	0.65	0.70	0.80	0.80	0.80
Downside risk	-0.25	-0.25	-0.25	-0.30	-0.30	-0.30	-0.35	-0.40	-0.45	-0.50	-0.55	-0.55	-0.55
1-yr LIBID rate													
Upside risk	0.35	0.30	0.35	0.40	0.45	0.50	0.60	0.70	0.75	0.75	0.75	0.80	0.80
Arlingclose Central Case	0.90	0.95	0.95	0.95	1.00	1.05	1.10	1.15	1.20	1.25	1.30	1.40	1.40
Downside risk	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
5-yr gilt yield													
Upside risk	0.50	0.75	0.75	0.75	0.85	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	1.45	1.50	1.55	1.60	1.65	1.70	1.75	1.85	1.95	2.10	2.30	2.50	2.50
Downside risk	-0.50	-0.50	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.65	-0.75	-0.80	-0.80	-0.80
10-yr gilt yield													
Upside risk	0.50	0.50	0.50	0.65	0.75	0.85	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	2.55	2.60	2.65	2.70	2.75	2.80	2.85	2.90	3.00	3.10	3.30	3.50	3.50
Downside risk	-0.50	-0.50	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.65	-0.75	-0.80	-0.80	-0.80
20-yr gilt yield													
Upside risk	0.50	0.75	0.75	0.75	0.85	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.25	3.30	3.35	3.40	3.45	3.50	3.55	3.65	3.75	3.85	4.05	4.15	4.15
Downside risk	-0.50	-0.50	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.65	-0.70	-0.75	-0.80	-0.80
50-yr gilt yield													
Upside risk	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.45	3.50	3.55	3.60	3.65	3.70	3.75	3.80	3.85	3.95	4.05	4.15	4.15
Downside risk	-0.50	-0.50	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.65	-0.70	-0.75	-0.80	-0.80

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

- **Group Limits** - For institutions within a banking group, the authority executes a limit at the highest of any of the single banks within that group.
- **Sovereign Limit** – The Council will only invest a maximum of 20% of the portfolio with non UK sovereigns.

Instrument	Country/ Domicile	Counterparty	Maximum Counterparty Limit %/£m	Maximum Group Limit (if applicable) %/£m	Council Holding At 31/12/13 £m
Term Deposits / CDs / Call Accounts	UK	Santander UK Plc (Banco Santander Group)	20	20	7
Term Deposits / CDs / Call Accounts	UK	Bank of Scotland (Lloyds Banking Group)	20	20	0
Term Deposits / CDs / Call Accounts	UK	Lloyds TSB (Lloyds Banking Group)	20	20	0
Term Deposits / CDs / Call Accounts	UK	Barclays Bank Plc	20	20	20
Term Deposits / CDs / Call Accounts	UK	HSBC Bank Plc	20	20	13
Term Deposits / CDs / Call Accounts	UK	Nationwide Building Society	20	20	0
Term Deposits / CDs / Call Accounts	UK	NatWest (RBS Group)	20	20	0
Term Deposits / CDs / Call Accounts	UK	Royal Bank of Scotland (RBS Group)	20	20	0
Term Deposits / CDs / Call Accounts	UK	Standard Chartered Bank	20	20	0
Term Deposits / CDs / Call Accounts	UK	Close Brothers Limited	20	20	0
Term Deposits / CDs / Call Accounts	UK	Goldman Sachs International Bank	20	20	0
Term Deposits / CDs / Call Accounts	UK	Leeds Building Society	20	20	0
Term Deposits / CDs / Call Accounts	Australia	Australia and NZ Banking Group	20	20	0

Term Deposits / CDs / Call Accounts	Australia	Commonwealth Bank of Australia	20	20	0
Term Deposits / CDs / Call Accounts	Australia	National Australia Bank Ltd (National Australia Bank Group)	20	20	0
Term Deposits / CDs / Call Accounts	Australia	Westpac Banking Corp	20	20	0
Term Deposits / CDs / Call Accounts	Canada	Bank of Montreal	20	20	0
Term Deposits / CDs / Call Accounts	Canada	Bank of Nova Scotia	20	20	0
Term Deposits / CDs / Call Accounts	Canada	Canadian Imperial Bank of Commerce	20	20	0
Term Deposits / CDs / Call Accounts	Canada	Royal Bank of Canada	20	20	0
Term Deposits / CDs / Call Accounts	Canada	Toronto-Dominion Bank	20	20	0
Term Deposits / CDs / Call Accounts	Finland	Nordea Bank Finland	20	20	0
Term Deposits / CDs / Call Accounts	Finland	Pohjola Bank	20	20	0
Term Deposits / CDs / Call Accounts	Germany	Deutsche Bank AG	20	20	0
Term Deposits / CDs / Call Accounts	Germany	Landesbank Hessen – Thuringen (Helaba)	20	20	0
Term Deposits / CDs / Call Accounts	Netherlands	ING Bank NV	20	20	0
Term Deposits / CDs / Call Accounts	Netherlands	Rabobank	20	20	0
Term Deposits / CDs / Call Accounts	Netherlands	Bank Nederlandse Gemeenten	20	20	0
Term Deposits / CDs / Call Accounts	Singapore	DBS Bank Ltd	20	20	0
Term Deposits / CDs / Call Accounts	Singapore	Oversea-Chinese Banking Corporation (OCBC)	20	20	0
Term Deposits / CDs / Call Accounts	Singapore	United Overseas bank (UOB)	20	20	0

Term Deposits / CDs / Call Accounts	Sweden	Svenska Handelsbanken	20	20	0
Term Deposits / CDs / Call Accounts	Switzerland	Credit Suisse	20	20	0
Term Deposits / CDs / Call Accounts	US	JP Morgan Chase Bank	20	20	0

***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. The counterparty list was correct as at 31 December 2013.*

SUMMARY OF INVESTMENTS**TOTAL RISK PER COUNTERPARTY AS AT 31 DECEMBER 2013**

	CREDIT RATING				TOTAL £000
<u>Fixed Deposits</u>					
Barclays	UK AAA	F1+AA-	B	1	20,000
HSBC	UK AAA	F1+AA	B	1	13,029
Santander	UK AAA	F1+AA-	B	1	6,800
TOTAL- FIXED TERM AND CASH DEPOSITS					39,829

SUMMARY BY SOVEREIGN RATING

	<u>£000</u>	<u>%</u>
UK AAA	39,829	100
Total	39,829	100

Credit Ratings – A Guide.

Long-term credit ratings and Sovereign Ratings

Fitch Rating' long-term credit ratings are set up along a scale from 'AAA' to 'D', first introduced in 1924 and later adopted and licensed by Standard & Poors (S&P). Moody's also uses a similar scale, but names the categories differently. Like S&P, Fitch also uses intermediate modifiers for each category between AA and CCC (i.e., AA+, AA, AA-, A+, A, A-, BBB+, BBB, BBB- etc.).

Investment grade

- **AAA** : the best quality, reliable and stable
- **AA** : good quality, a bit higher risk than AAA
- **A** : economic situation can affect finance
- **BBB** : medium class counterparties, which are satisfactory at the moment

Non-investment grade

- **BB** : more prone to changes in the economy
- **B** : financial situation varies noticeably
- **CCC** : currently vulnerable and dependent on favourable economic conditions to meet its commitments
- **CC** : highly vulnerable, very speculative bonds
- **C** : highly vulnerable, perhaps in bankruptcy or in arrears but still continuing to pay out on obligations
- **D** : has defaulted on obligations and Fitch believes that it will generally default on most or all obligations
- **NR** : not publicly rated

Short-term credit ratings

Fitch's short-term ratings indicate the potential level of default within a 12-month period.

- **F1+** : best quality grade, indicating exceptionally strong capacity of obligor to meet its financial commitment
- **F1** : best quality grade, indicating strong capacity of obligor to meet its financial commitment
- **F2** : good quality grade with satisfactory capacity of obligor to meet its financial commitment
- **F3** : fair quality grade with adequate capacity of obligor to meet its financial commitment but near term adverse conditions could impact the obligor's commitments
- **B** : of speculative nature and obligor has minimal capacity to meet its commitment and vulnerability to short term adverse changes in financial and economic conditions
- **C** : possibility of default is high and the financial commitment of the obligor are dependent upon sustained, favourable business and economic conditions
- **D** : the obligor is in default as it has failed on its financial commitments.

Bank Individual Ratings

Individual Ratings are assigned to banks that are legal entities. The term "banks" here includes bank holding companies and bank assurance holding companies, bank assurance companies operating as single legal entities, investment banks and private banks. These ratings may also be assigned to leasing companies, instalment credit companies, credit card companies, brokerage houses, investment management companies and securities dealing companies, as circumstances demand. These ratings, which are internationally comparable, attempt to assess how a bank would be viewed if it were entirely independent and could not rely on external support. These ratings are designed to assess a bank's exposure to, appetite for, and management of risk, and thus represent the agency's view on the likelihood that it would run into significant financial difficulties such that it would require support.

- A:** A very strong bank. Characteristics may include outstanding profitability and balance sheet integrity, franchise, management, operating environment or prospects.
- B:** A strong bank. There are no major concerns regarding the bank. Characteristics may include strong profitability and balance sheet integrity, franchise, management, operating environment or prospects.
- C:** An adequate bank, which, however, possesses one or more troublesome aspects. There may be some concerns regarding its profitability and balance sheet integrity, franchise, management, operating environment or prospects.
- D:** A bank that has weaknesses of internal and/or external origin. There are concerns regarding its profitability and balance sheet integrity, franchise, management, operating environment or prospects. Banks in emerging markets are necessarily faced with a greater number of potential deficiencies of external origin.
- E:** A bank with very serious problems, which either requires or is likely to require external support.
- F:** A bank that has either defaulted or, in Fitch Ratings' opinion, would have defaulted if it had not received external support. Examples of such support include state or local government support, (deposit) insurance funds, acquisition by some other corporate entity or an injection of new funds from its shareholders or equivalent.

Notes: Gradations may be used among the ratings A to E: i.e. A/B, B/C, C/D, and D/E. No gradations apply to the F rating.

Support Ratings (1 – 5)

The Purpose and Function of Support Ratings

Support Ratings are Fitch Ratings' assessment of a potential supporter's propensity to support a bank and of its ability to support it. Its propensity to support is a judgment made by Fitch Ratings. Its ability to support is set by the potential supporter's own Issuer Default Ratings, both in foreign currency and, where appropriate, in local currency. Support Ratings do not assess the intrinsic credit quality of a bank. Rather they communicate the agency's judgment on whether the bank would receive support should this become necessary. These ratings are exclusively the expression of Fitch Ratings' opinion even though the principles underlying them may have been discussed with the relevant supervisory authorities and/or owners.

Timeliness and Effectiveness Requirements

Fitch Ratings' Support Rating definitions are predicated on the assumption that any necessary "support" is provided on a timely basis. The definitions are also predicated on the

assumption that any necessary support will be sufficiently sustained so that the bank being supported is able to continue meeting its financial commitments until the crisis is over.

Obligations and Financial Instruments Covered

In terms of these definitions, unless otherwise specified, "support" is deemed to be in terms of foreign currency. It is assumed that typically the following obligations will be supported: senior debt (secured and unsecured), including insured and uninsured deposits (retail, wholesale and interbank); obligations arising from derivatives transactions and from legally enforceable guarantees and indemnities, letters of credit, and acceptances; trade receivables and obligations arising from court judgments.

Likewise, the agency does not assume that the following capital instruments will be supported when sovereign support is involved: preference/preferred shares or stock; hybrid capital (tier 1 and upper tier 2), including reserve capital instruments (RCIs) and variations upon RCIs; and common/ordinary equity capital. It is also assumed that there will be no support for any moral obligation on securitizations. The sovereign support status of subordinated debt is difficult to categorize in advance; it is assessed on a case by case basis, distinguishing among different jurisdictions.

Definitions:

- 1:** A bank for which there is an extremely high probability of external support. The potential provider of support is very highly rated in its own right and has a very high propensity to support the bank in question. This probability of support indicates a minimum Long-Term Rating floor of 'A-'.
- 2:** A bank for which there is a high probability of external support. The potential provider of support is highly rated in its own right and has a high propensity to provide support to the bank in question. This probability of support indicates a minimum Long-Term Rating floor of 'BBB-'.
- 3:** A bank for which there is a moderate probability of support because of uncertainties about the ability or propensity of the potential provider of support to do so. This probability of support indicates a minimum Long-Term Rating floor of 'BB-'.
- 4:** A bank for which there is a limited probability of support because of significant uncertainties about the ability or propensity of any possible provider of support to do so. This probability of support indicates a minimum Long-Term Rating floor of 'B'.
- 5:** A bank for which external support, although possible, cannot be relied upon. This may be due to a lack of propensity to provide support or to very weak financial ability to do so. This probability of support indicates a Long-Term Rating floor no higher than 'B-' and in many cases no floor at all.

GLOSSARY

Term	Meaning
Affordable Borrowing Limit	The amount the authority would normally borrow at any point of time in the year. This boundary might be exceeded temporarily but only in exceptional circumstances. The limit is set by Full Council at the beginning of March and is a prudential indicator.
Authorised Borrowing Limit	The maximum amount the authority can borrow at any point of time in the year. This limit should never be exceeded. The limit is set by Full Council at the beginning of March and is a prudential indicator.
Capital Financing Requirement (CFR)	This represents the underlying need for the authority to borrow and represents the assets of the authority less the long term capital liabilities.
Credit Default Swaps (CDS)	CDS are bought by investors to insure against defaults (i.e. the counterparty not being able to repay). The higher the cost/premium then the higher the risk – CDS therefore given a market view of the credit worthiness of an organisation.
Credit Ratings	Rating on the ability of an organisation to meet its obligations; ratings are assigned by independent, specialist companies, such as Fitch and Moodys using market intelligence they gather.
Credit Risk	The risk that the debtor will default on their obligations
Counterparty	The organisation that you are conducting your business with.
Debt Management Account Deposit Facility	Provided by the <u>Debt Management Office</u> , users can place cash in secure fixed-term deposits. Deposits are guaranteed by the government and therefore have the equivalent of a sovereign triple-A credit rating.
Derivative Instruments	A security whose price is dependent upon or derived from one or more underlying assets. The derivative itself is merely a contract between two or more parties. Its value is determined by fluctuations in the underlying asset. The most common underlying assets include stocks, bonds, commodities, currencies, interest rates and market indexes. Most derivatives are characterized by high leverage. For example, a stock option is a derivative because it derives its value from the value

	of a stock. An interest rate swap is a derivative because it derives its value from one or more interest rate indices.
Discounts	These relate to Public Works Loans Board loans. If rates have increased since the borrowing was undertaken then part of the benefit that PWLB will achieve from being able to loan out at that higher rate are passed back to an authority if they repay the loan early.
Fund Managers	Independent investment managers who work to a specific mandate and invest funds on behalf of the Council
Inflation	The rise in prices of goods and services over a period of time.
Interest Rate Risk	The risk that the value of an investment will change due to changes to the interest rate.
Internal Borrowing	This is where the amount of an authority's borrowing is less than its CFR or underlying need to borrow and represents the use of internal balances rather than borrowing from the market.
LIBID	London inter-bank bid rate. Interest rate at which prime banks will borrow money in the London inter-bank market.
LIBOR	London inter-bank offer rate. Interest rate at which prime banks will lend money in the London inter-bank market. Fixed every day by the British Bankers Association to five decimal places.
Liquidity Risk	The risk of not being able to trade an investment quickly to release cash.
Minimum Revenue Provision (MRP)	This is the amount charged against the Income and Expenditure Account for the year in relation to the repayment of debt on borrowing in order to fund capital expenditure.
Obligor	An individual or company that owes debt to another individual or company (the creditor), as a result of borrowing or issuing bonds.
Premia	This is the penalty applied to the early redemption of PWLB loans where rates have fallen since the loan was undertaken.
Prudential Code	A professional code of practice which provides regulatory framework to local authorities on capital expenditure, investments and borrowing activities.
Prudential Indicators	A set of indicators developed within the Prudential Code which define thresholds for investment and borrowing within a local authority.

PWLB	Public Works Loans Board – a Government agency providing long and short term loans to local authorities. Interest rates are generally lower than the private sector and slightly higher than the rates at which the Government themselves may borrow.
Re-scheduling	This relates to repaying existing borrowing early and replacing it with borrowing for a different period usually, but not necessarily, at lower rates
Return	The gain from holding an investment over a given period
Security	An investment instrument, other than an insurance policy or fixed annuity, issued by a corporation, government or other organisation which offers evidence of debt or equity.
Sovereign Exposure	Risk of exposure to one particular country.
Supranational Bonds	These are bonds (similar to gilts) issued by multi government development organisations and are supported by all of the governments who form part of the organisation. E.g. European Investment Bank and are usually very secure.
Quantative Easing	This is where the government buy back there own gilt issuance to effectively pump money into the financial markets of the economy.