Taunton Deane Borough Council

Executive – 6 February 2013

Treasury Management Strategy Statement and Investment Strategy

Report of the Strategic Finance Officer
(This matter is the responsibility of Executive Councillor Williams – Leader of the Council)

1. Executive Summary

- Council debt at the time of writing this report is £94.999m which includes the HRA self-financing debt of £85.2m
- Short-term interest rates are currently 0.5% and are expected to be at this level for the next financial year.
- The strategy has the preservation of capital as the most important factor in investing taxpayers money
- Borrowing rates are currently low but the cost of carry must be considered before taking on any debt.

2. Background

2.1 The purpose of this Treasury Management Strategy Statement and Investment Strategy (TMSS) is to approve:-

- The Treasury Management Strategy for 2013/2014 (Borrowing and Debt Rescheduling); and
- Use of Specified and Non-Specified Investments.

2.2 The treasury management service is an important part of the overall financial management of the Council's affairs

2.3 The bank base rate fell to 0.5% in March 2009 and has remained at that level ever since. Our advisors suggest that the interest rates will remain low for even longer, until at least 2016 given the extension of austerity measures announced in the Chancellor's Autumn Statement.

2.4 During 2012/13, the ratings agencies continued to downgrade sovereign ratings and individual institutions; the Council has responded by listening to and following advice from our treasury advisors Arlingclose.

3. Treasury Management Strategy Statement (TMSS) and Investment Strategy

3.1 This strategy is written in continuing challenging and uncertain economic times. The current economic outlook has a several key treasury management implications:

- Investment returns are likely to remain relatively low during 2013/14;
- Borrowing interest rates are currently attractive, but may remain low for some time.
- The timing of any borrowing will need to be monitored carefully; there will remain a cost of carry – any borrowing undertaken that results in an increase in investments will incur a revenue loss between borrowing costs and investment returns.

3.2 This strategy looks to reduce exposure to risk and volatility at this time of significant economic uncertainty by;

- Considering security, liquidity and yield, in that order.
- Considering alternative assessments of credit strength (see 11.3 in appendix B of the strategy)
- Spreading investments over a range of approved counterparties.
- Only investing for longer periods to gain higher rates of return where there are acceptable levels of counterparty risk.

3.3 The historically low interest rate situation has led to significant reductions in investment income in the past years which impacts directly on the Council's budget.

3.4 The council's general fund capital financing requirement (CFR) for 2013/14 is £7.688m which is currently funded through internal borrowing. The council is able to borrow funds in excess of the current CFR up to the projected level in 2015/16 of £7.086. The timing of any borrowing must be considered as mentioned in 3.1 above.

3.5 Appendix 1 gives the full TMSS.

4. Finance Comments

4.1 This is a finance report and there are no further comments to make.

5. Legal Comments

5.1 There are no legal implications of this report.

6. Links to Corporate Aims

6.1 The TMSS supports the funding of projects as well as the general fund, which in turn support the Corporate Aims.

7. Environmental Implications

7.1 No environmental implications have been identified.

8. Community Safety Implications

8.1 No community safety implications have been identified.

9. Equalities Impact

9.1 After initial screening no Equality Impacts were identified for any specific group

10. Risk Management

10.1 There are both credit and liquidity risk surrounding treasury activities. This strategy looks to minimise the council's exposure to these risks.

11. Partnership Implications

11.1 Southwest One performs the treasury management function on behalf of Taunton Deane Borough Council. Southwest One will adhere to this strategy.

12. Recommendations

12.1 That the Executive recommends that Council approves the Treasury Management Strategy Statement and Investment Strategy outlined in Appendix 1.

12.2 That the Executive recommends that the Council approves the Prudential Indicators in Appendix B of the Treasury Management Strategy Statement and Investment Strategy.

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Appendix

Treasury Management Strategy Statement and Investment Strategy

2013/14 to 2015/16 and revisions to 2012/13 Strategy

1. Background

1.1. 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 (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. As per the requirements of the Prudential Code, the Council has adopted the CIPFA Treasury Management Code.

1.3. The purpose of this TMSS is, therefore, to approve:

- Revisions to Treasury Management Strategy and Prudential Indicators for 2012/13
- Treasury Management Strategy for 2013/14
- Annual Investment Strategy for 2013/14
- Prudential Indicators for 2013/14, 2014/15 and 2015/16
- MRP Statement

1.4. The Council has borrowed and invested substantial sums of money and therefore has potentially large exposures to financial risks including the loss of invested funds and the effect of changing interest rates. The successful identification, monitoring and control of risk is therefore central to the Council's treasury management strategy.

2. Capital Financing Requirement

2.1 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). The CFR, together with Usable Reserves, are the core drivers of the Council's Treasury Management activities.

2.2 The Council's currently has £94.999m of debt and £27.6m of investments as at 9 January 2013. This is set out in further detail at ***Appendix A***.

2.3 **Money Borrowed in Advance of Spending Need:** The Council is able to borrow funds in excess of the current level of its CFR up to the projected level in 2015/16. The Council 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.

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

Table 1: Balance Sheet Summary Analysis

	2012/13 Estimate £'000	**2013/14 Estimate £'000**	**2014/15 Estimate £'000**	**2015/16 Estimate £'000**
General Fund CFR	6,967	7,688	7,381	7,086
HRA CFR	97,425	102,232	104,799	102,599
Total CFR	**104,392**	**109,920**	**112,180**	**109,685**
Less: Existing Profile of Borrowing	(94,198)	(89,198)	(87,198)	(87,198)
Less: Other Long Term Liabilities	0	0	0	0
Cumulative Maximum External Borrowing Requirement/(Investments)	**10,194**	**20,722**	**24,982**	**22,487**
Usable Reserves	(13,200)	(12,300)	(10,700)	(8,500)
Cumulative Net Borrowing Requirement/(Investments)	**(3,006)**	**8,422**	**14,282**	**13,987**

3. Interest Rate Forecast

3.1 The Arlingclose interest rate forecast continues its theme of the last few years, that is, that interest rates will remain low for even longer. Indeed, the forecast is for official UK interest rates to remain at 0.5% until 2016 given the moribund outlook for economic growth and the extension of austerity measures announced in the Chancellor's Autumn Statement. Until there is a credible resolution of the problems that stalk the Eurozone – and that resolution requires full-scale fiscal union which faces many significant political hurdles – then the UK's safe haven status and minimal prospect of increases in official interest rates will continue to combine and support the theme within the forecast.

3.2 The economic and interest rate forecast provided by the Council's treasury management advisor is attached at ***Appendix C***. The Council will reappraise its strategies from time to time in response to evolving economic, political and financial events.

4. Borrowing Strategy

4.1 Treasury management and borrowing strategies in particular continue to be influenced not only by the absolute level of borrowing rates but also the relationship between short and long term interest rates. 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. The cost of carry is likely to be an issue until 2016 or beyond. As borrowing is often for longer dated periods (anything up to 50 years) the cost of carry needs to be considered against a backdrop of uncertainty and affordability constraints in the Council’s wider financial position.

4.2 As indicated in Table 1, the Council has a gross and net borrowing requirement and could potentially be required to borrow up to £8.4m. The Council will adopt a flexible approach to this borrowing in consultation with its treasury management advisors, Arlingclose Ltd. The following issues will be considered prior to undertaking any external borrowing:

- Affordability;
- Maturity profile of existing debt;
- Interest Rate and refinancing risk;
- Borrowing source.

5. Sources of Borrowing and Portfolio Implications

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

- Internal
- PWLB
- Local authorities
- European Investment Bank *(NB the EIB will only lend up to 50% towards the funding of a specific project and needs to meet the EIB’s specific criteria)*
- Leasing
- Structured finance
- Capital markets (stock issues, commercial paper and bills)
- Commercial banks

5.2 The cost of carry has resulted in an increased reliance upon shorter dated and variable rate borrowing. This type of borrowing injects volatility into the debt portfolio in terms of interest rate risk but is counterbalanced by its affordability and alignment of borrowing costs with investment returns. The Council’s exposure to shorter dated and variable rate borrowing is kept under regular review by reference to the difference or spread between variable rate and longer term borrowing costs. A significant narrowing in the spread (e.g. by 0.50%) will result in an immediate and formal review of the borrowing strategy to determine whether the exposure to shorter dated and variable rates is maintained or altered.

5.3 The Council has £3m exposure to LOBO loans (Lender's Option Borrower's Option) of which £3m of these can be "called" within 2013/14. A LOBO is called when the Lender exercises its right to amend the interest rate on the loan at which point the Borrower can accept the revised terms or reject them and repay the loan. LOBO loans present a potential refinancing risk to the Council since the decision to call a LOBO is entirely at the lender's discretion.

Any LOBOs called will be discussed with the treasury advisers prior to acceptance of any revised terms. The default position will be the repayment of the LOBO without penalty i.e. the revised terms will not be accepted.

6. Debt Rescheduling

6.1 The Council's debt portfolio can be restructured by prematurely repaying loans and refinancing them on similar or different terms to achieve a reduction in risk and/or savings in interest costs.

6.2 The lower interest rate environment and changes in the rules regarding the premature repayment of PWLB loans has adversely affected the scope to undertake meaningful debt restructuring although occasional opportunities arise. The rationale for undertaking any debt rescheduling or repayment would be one or more of the following:

- Reduce investment balances and credit exposure via debt repayment
- Align long-term cash flow projections and debt levels
- Savings in risk adjusted interest costs
- Rebalancing the interest rate structure of the debt portfolio
- Changing the maturity profile of the debt portfolio

6.3 Borrowing and rescheduling activity will be reported to the Executive in the Annual Treasury Management Report and the regular treasury management reports presented to the Executive

7. Annual Investment Strategy

7.1 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 of capital. The liquidity or accessibility of the Council's investments is secondary, followed by the yield earned on investments which is a tertiary consideration.

7.2 The Council and its advisors remain on a heightened state of alert for signs of credit or market distress that might adversely affect the Council.

7.3 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 and are not deemed capital expenditure investments under Statute. Non specified investments are, effectively, everything else.

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

Table 2: Specified and Non-Specified Investments

Investment	Specified	Non-Specified
Term deposits with banks and building societies	✓	✓
Term deposits with other UK local authorities	✓	✓
Investments with Registered Providers	✓	✓
Certificates of deposit with banks and building societies	✓	✓
Gilts	✓	✓
Treasury Bills (T-Bills)	✓	×
Bonds issued by Multilateral Development Banks	✓	✓
Local Council Bills	✓	×
Commercial Paper	✓	×
Corporate Bonds	✓	✓
AAA-Rated Money Market Funds	✓	×
Other Money Market and Collective Investment Schemes	✓	✓
Debt Management Account Deposit Facility	✓	×
Investments with other organisations (subject to an external credit assessment and advice from Treasury Managment Advisor)	×	✓

Further details can be found in **Appendix D & E**.

7.5 Registered Providers (RPs) have been included within specified and non-specified investments for 2013/14. Investments with RPs will be analysed on an individual basis and discussed with Arlingclose prior to investing.

7.6 Investments with other organisations have been included as a non-specified investment category for 2013-14. This would include investment opportunities with small and medium sized enterprises (SMEs) and other businesses across the UK. Because of the higher perceived credit risk of SMEs, such investments may provide considerably higher rates of return. An external credit assessment will be undertaken and advice from the Council's Treasury Management adviser will be sought (where available) before any investment decision is made.

7.7 The minimum credit rating for non-UK sovereigns is AA+ (or equivalent). For specified investments the minimum long term rating for counterparties is A- (or equivalent). As detailed in non-specified investments in Appendix E, the s151 officer will have discretion to make investments with counterparties that do not meet the specified criteria on advice from Arlingclose.

The other credit characteristics, in addition to credit ratings, that the Council monitors are listed in the Prudential Indicator on Credit Risk (PI 12, page 17).

Any institution will be suspended or removed should any of the factors identified above give rise to concern. Specifically credit ratings are monitored by the Council on a daily basis. Arlingclose advises the Council on ratings changes and appropriate action to be taken.

The countries and institutions that currently meet the criteria for investments 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.

7.8 **Council's Banker** – The Council banks with National Westminster Plc. At the current time, it does meet the Council's minimum credit criteria. Even if the credit rating falls below the Council's minimum criteria Natwest will continue to be used for short term liquidity requirements (overnight and weekend investments) and business continuity arrangements.

8. Investment Strategy

8.1 With short term interest rates low for some time, an investment strategy will typically result in a lengthening of investment periods, where cash flow permits, in order to lock in higher rates of acceptable risk adjusted returns. The problem in the current environment is finding an investment counterparty providing acceptable levels of counterparty risk.

8.2 In order to diversify a portfolio largely invested in cash, investments will be placed with approved counterparties over a range of maturity periods. Maximum investment levels with each counterparty will be set to ensure prudent diversification is achieved.

8.3 Money market funds (MMFs) will be utilised but good treasury management practice prevails and whilst MMFs provide good diversification the Council will also seek to mitigate operational risk by utilising at least two MMFs. The Council will also restrict its exposure to MMFs with lower levels of funds under management and will not exceed 0.5% of the net asset value of the MMF. In the case of Government MMFs, the Council will ensure exposure to each Fund does not exceed 2% of the net asset value of the Fund. The Council will manage the investments in MMFs so that no more than 50% of its total investments are in MMFs.

8.4 Collective Investment Schemes (Pooled Funds):

The Council has evaluated the use of Pooled Funds and determined the appropriateness of their use within the investment portfolio. Pooled funds enable the Council to diversify the assets and the underlying risk in the investment portfolio and provide the potential for enhanced returns.

8.5 Investments in pooled funds will be undertaken with advice from Arlingclose Ltd.

9. Policy on Use of Financial Derivatives

9.1 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 CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

9.2 The Council 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 Council 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.

9.3 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.

9.4 The local Council will only use derivatives after seeking expertise, a legal opinion and ensuring officers have the appropriate training for their use.

10. Housing Revenue Account Self-Financing

10.1 Central Government completed its reform of the Housing Revenue Account Subsidy system at the end of 2011/12. Local authorities are required to recharge interest expenditure and income attributable to the HRA in accordance with Determinations issued by the Department for Communities and Local Government.

10.2 The Determinations do not set out a methodology for calculating the interest rate to use in each instance. The Council is therefore required to adopt a policy that will set out how interest charges attributable to the HRA will be determined. The CIPFA Code recommends that authorities present this policy in their TMSS.

10.3 On 1 April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account.

10.4 Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured each month and interest transferred between the General Fund and HRA at the monthly net average rate earned by the Council on its portfolios of treasury investments and short-term borrowing.

11. 2013/14 MRP Statement

11.1 The Council is required to set an annual policy on the way it calculates the prudent provision for the repayment of borrowing (MRP). This year's policy can be found in Appendix F of this report.

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

12.1 The Principal Accountant will report to the Executive on treasury management activity/performance and Performance Indicators as follows:

- 6 monthly against the strategy approved for the year. The Council will produce an outturn report on its treasury activity no later than 30th September after the financial year end.
- The Executive will be responsible for the scrutiny of treasury management activity and practices.

13. Other Items

13.1 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:

Taunton Deane Borough Council trains new members in its finances including treasury management. Refresher financial training is offered which includes treasury management. Our treasury advisors also present to members at Members Briefings. Council staff (including SWOne secondees) attend regular treasury management training.

13.2 Treasury Management Advisors

The Council uses Arlingclose as Treasury Management Advisors and receives the following services:

- Credit advice
- Investment advice
- Technical advice
- Economic & interest rate forecasts
- Workshops and training events
- HRA support
- Etc.

The Council maintains the quality of the service with its advisors by holding quarterly meetings and tendering periodically.

Appendix A – Existing Investment & Debt Portfolio Position (Section 2.2)

	09/10/2012 Actual Portfolio £'000	09/10/2012 Average Rate
External Borrowing:		
PWLB – Fixed Rate	86,198	3.03%
PWLB – Variable Rate	5,000	0.62%
LOBO Loans	3,000	4.25%
RIF Loan	801	0%
Total External Borrowing	**94,999**	
Investments:		
Short-term investments	27,600	0.70%
Total Investments	**27,600**	
Net Debt	**67,399**	

Appendix B
Prudential Indicators revisions to 2012/13 and 2013/14 – 2015/16

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 Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

If in any of these years there is a reduction in the capital financing requirement, this reduction is ignored in estimating the cumulative increase in the capital financing requirement which is used for comparison with **gross** external debt.

The s.151 officer reports that the Council had no difficulty meeting this requirement in 2012/13, 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	2012/13 Approved £'000	2012/13 Revised £'000	2013/14 Estimate £'000	2014/15 Estimate £'000	2015/16 Estimate £'000
Non-HRA	1,794	6,948	**3,553**	1,264	1,010
HRA	5,500	5,500	**14,805**	12,498	7,659
Total	**7,294**	**12,448**	**18,358**	**13,762**	**8,669**

3.2 Capital expenditure will be financed or funded as follows:

Capital Financing	**2012/13 Approved £'000**	**2012/13 Revised £'000**	**2013/14 Estimate £'000**	**2014/15 Estimate £'000**	**2015/16 Estimate £'000**
Capital Receipts	445	993	**1,229**	735	171
Government Grants	480	2,777	**787**	300	310
Revenue Contributions	6,369	7,103	**9,342**	8,660	8,188
Unsupported borrowing	0	1,575	**7,000**	4,067	0
Total Financing and Funding	**7,294**	**12,448**	**18,358**	**13,762**	**8,669**

Table 1 shows that the capital expenditure plans of the Council cannot be funded entirely from sources other than external borrowing.

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. This ratio can be negative for Councils in a net investment position. 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	**2012/13 Approved %**	**2012/13 Revised %**	**2013/14 Estimate %**	**2014/15 Estimate %**	**2015/16 Estimate %**
Non-HRA	0.82	(2.62)	**(2.52)**	(2.66)	(2.77)
HRA	17.05	12.06	**12.03**	11.32	10.41
Total	**17.87**	**9.44**	**9.51**	**8.66**	**7.64**

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 financing.

Capital Financing Requirement	2012/13 Approved £'000	2012/13 Revised £'000	2013/14 Estimate £'000	2014/15 Estimate £'000	2015/16 Estimate £'000
Non-HRA	9,181	6,967	**7,688**	7,381	7,086
HRA	99,649	97,425	**102,232**	104,799	102,599
Total CFR	**108,830**	**104,392**	**109,920**	**112,180**	**109,685**

6. Incremental Impact of Capital Investment Decisions:

6.1 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 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	2012/13 Approved £	2013/14 Estimate £	2014/15 Estimate £	2015/16 Estimate £
Increase in Band D Council Tax	3.96	**1.33**	(0.57)	(0.83)
Increase in Average Weekly Housing Rents	0.00	**0.78**	0.56	0.04

7. Authorised Limit and Operational Boundary for External Debt:

7.1 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.

7.2 The **Authorised Limit** sets the maximum level of external debt on a gross basis (i.e. excluding investments) for the Council. It is measured on a daily basis against all external debt 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.

7.3 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).

7.4 The Operational Boundary has been set on the estimate of the most likely, i.e. prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.

7.5 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.

	2012/13 **Approved £'000**	**2012/13** **Revised £'000**	**2013/14** **Estimate £'000**	**2014/15** **Estimate £'000**	**2015/16** **Estimate £'000**
Authorised Limit for External Debt	139,200	139,200	**166,920**	166,247	159,685
Operational Boundary for External Debt	103,020	103,020	**146,920**	146,247	139,685

7.6 The HRA has a debt cap of £115.8m which is a figure set by Central Government.

8. Adoption of the CIPFA Treasury Management Code:

8.1 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 Executive meeting on 14 January 2004

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

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

9.1 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 *(select as* *appropriate)* net principal outstanding sums, (i.e. fixed rate debt net of fixed rate investments / net interest paid (i.e. interest paid on fixed rate debt net of interest received on fixed rate investments)

9.2 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 or Benchmark level at 31/03/12 %**	**2012/13 Approved %**	**2012/13 Revised %**	**2013/14 Estimate %**	**2014/15 Estimate %**	**2015/16 Estimate %**
<u>Fixed</u>						
Interest payable on fixed rate borrowing /Principal sums outstanding on fixed rate borrowing	94.69	100	100	100	100	100
Less: Interest receivable on fixed rate investments/ Principal sums outstanding on fixed rate investments	(55.56)	(100)	(100)	(100)	(100)	(100)
Upper Limit for Fixed Interest Rate Exposure	**39.13**	**0**	**0**	**0**	**0**	**0**
<u>Variable</u>						
Interest payable on variable rate borrowing/Principal sums outstanding on variable rate borrowing	5.31	50	50	50	50	50
Less: Interest receivable on variable rate investments/ Principal sums outstanding on variable rate investments	(44.44)	(100)	(100)	(100)	(100)	(100)
Upper Limit for Variable Interest Rate Exposure	**(39.13)**	**(50)**	**(50)**	**(50)**	**(50)**	**(50)**

9.3 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.

10. Maturity Structure of Fixed Rate borrowing:

10.1 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.

10.2 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.

10.3 LOBOs are classified as maturing on the next call date i.e. the earliest date that the lender can require repayment.

Maturity structure of fixed rate borrowing	**Existing level %**	**Lower Limit for 2013/14 %**	**Upper Limit for 2014/15 %**
under 12 months	0.89	0	50
12 months and within 24	0	0	50
24 months and within 5	5.22	0	50
5 years and within 10 years	21.11	0	50
10 years and within 20	72.78	0	100
20 years and within 30		0	100
30 years and within 40		0	100
40 years and within 50		0	100
50 years and above		0	100

11. Credit Risk:

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

11.2 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.

11.3 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.

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

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

12.1 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	**2012/13 Approved**	**2012/13 Revised**	**2013/14 Estimate**	**2014/15 Estimate**	**2015/16 Estimate**
	£3.5m	£3.5m	£3.5m	£3.5m	£3.5m

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

	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Official Bank Rate													
Upside risk			0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**0.50**	**0.50**	**0.50**	**0.50**	**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	-0.25	-0.25
3-month LIBID													
Upside risk	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75
Central case	**0.40**	**0.40**	**0.40**	**0.45**	**0.45**	**0.50**	**0.50**	**0.50**	**0.55**	**0.55**	**0.55**	**0.60**	**0.60**
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
1-yr LIBID													
Upside risk	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75
Central case	**0.85**	**0.90**	**0.95**	**0.95**	**1.00**	**1.00**	**1.00**	**1.00**	**1.10**	**1.10**	**1.10**	**1.10**	**1.10**
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
5-yr gilt													
Upside risk	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00
Central case	**0.95**	**0.95**	**0.95**	**0.95**	**1.00**	**1.00**	**1.00**	**1.00**	**1.10**	**1.10**	**1.10**	**1.20**	**1.20**
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
10-yr gilt													
Upside risk	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.00	1.00
Central case	**2.00**	**2.00**	**2.05**	**2.05**	**2.05**	**2.05**	**2.10**	**2.10**	**2.10**	**2.20**	**2.20**	**2.20**	**2.20**
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
20-yr gilt													
Upside risk	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00
Central case	**2.90**	**2.90**	**2.90**	**2.90**	**3.00**	**3.00**	**3.00**	**3.00**	**3.10**	**3.10**	**3.10**	**3.10**	**3.10**
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
50-yr gilt													
Upside risk	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00
Central case	**3.35**	**3.35**	**3.35**	**3.40**	**3.40**	**3.40**	**3.50**	**3.50**	**3.50**	**3.50**	**3.60**	**3.60**	**3.60**
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25

Underlying Assumptions:

- UK growth is unlikely to return to above trend for the foreseeable future. Q3 GDP was strong at 0.9% but this momentum is unlikely to be sustained in Q4 or in 2013. The rebalancing from public-sector driven consumption to private sector demand and investment is yet to manifest, and there is little sign of productivity growth. Further contraction in the Eurozone, including Germany's powerful economy, and slower forecast growth in the emerging economies (Brazil/Mexico/India) are exacerbating the weakness.
- Consumer Price Inflation has fallen to 2.7 % from a peak of 5.2%. Near term CPI is likely to be affected by volatility in commodity prices and its decrease towards the 2% target is expected to be slower than previously estimated. Real wage growth (i.e. after inflation) is forecast to remain weak.
- The fiscal outlook for bringing down the structural deficit and stabilise debt levels remains very challenging. Weakened credibility of the UK reining its levels of debt poses a risk to the AAA status, but recent history (US, France) suggests this may not automatically result in a sell-off in gilts.
- In the absence of large, unexpected decline in growth, QE is likely to remain on hold at £375bn for now. The availability of cheaper bank borrowing and subsequently for corporates through the Funding for Lending Scheme (FLS) is a supporting factor.
- The US Federal Reserve's shift in its rate guidance from a date-based indication to economic thresholds (6.5% unemployment, inflation 1 – 2 years out projected to remain below 2.5%, longer term inflation expectations remain

well anchored) is likely to increase market uncertainty around the highly volatile US employment data releases.

- The Eurozone is making slow headway which has curtailed some of the immediate risks although peripheral countries continue to struggle. Fully-fledged banking and fiscal union is still some years away.
- In the US, the issues of spending cuts, reducing the budget deficit and raising the country's debt ceiling remain unresolved. A failure to address these by March 2013 could lead to a similar showdown and risks a downgrade to the US sovereign credit rating by one or more agencies.
- A reversal in market risk sentiment from current "risk on" to "risk off" could be triggered by economic and/or political events – impending Italian and German elections, US debt ceiling impasse, difficulty surrounding Cyprus' bailout, and contagion returning the haunt the European peripheral nations – could inject renewed volatility into gilts and sovereign bonds.

Appendix D – Current Recommended Sovereign and Counterparty List as at 24/10/2012 (Section 8)

Please complete with your own Council's limits for investments and duration:

Country/ Domicile	**Counterparty**	**Maximum Counterparty Limit %/£m**	**Maximum Group Limit (if applicable) %/£m**	**Maximum Maturity Limit***
UK	Santander UK Plc (Banco Santander Group)	£3.5m		2 years
UK	Bank of Scotland (Lloyds Banking Group)	£3.5m	£5.25m	2 years
UK	Lloyds TSB (Lloyds Banking Group)	£3.5m		2 years
UK	Barclays Bank Plc	£3.5m		2 years
UK	HSBC Bank Plc	£3.5m		2 years
UK	Nationwide Building Society	£3.5m		2 years
UK	NatWest (RBS Group)	£3.5m	£5.25m	2 years
UK	Royal Bank of Scotland (RBS Group)	£3.5m		2 years
UK	Standard Chartered Bank	£3.5m		2 years
Australia	Australia and NZ Banking Group	£3.5m		2 years
Australia	Commonwealth Bank of Australia	£3.5m		2 years
Australia	National Australia Bank Ltd (National Australia Bank Group)	£3.5m		2 years
Australia	Westpac Banking Corp	£3.5m		2 years
Canada	Bank of Montreal	£3.5m		2 years
Canada	Bank of Nova Scotia	£3.5m		2 years
Canada	Canadian Imperial Bank of Commerce	£3.5m		2 years
Canada	Royal Bank of Canada	£3.5m		2 years

Canada	Toronto-Dominion Bank	£3.5m		2 years
Finland	Nordea Bank Finland	£3.5m		2 years
France	BNP Paribas	£3.5m		2 years
France	Credit Agricole CIB (Credit Agricole Group)	£3.5m	£5.25m	2 years
France	Credit Agricole SA (Credit Agricole Group)	£3.5m		2 years
France	Société Générale	£3.5m		2 years
Germany	Deutsche Bank AG	£3.5m		2 years
Netherlands	ING Bank NV	£3.5m		2 years
Netherlands	Rabobank	£3.5m		2 years
Netherlands	Bank Nederlandse Gemeenten	£3.5m		2 years
Sweden	Svenska Handelsbanken	£3.5m		2 years
Switzerland	Credit Suisse	£3.5m		2 years
US	JP Morgan	£3.5m		2 years

***Please note this list could change if, for example, a counterparty/country is upgraded, and meets our other creditworthiness tools or a new suitable counterparty comes into the market. Alternatively, if a counterparty is downgraded, this list may be shortened.*
**2 years is the maximum approved duration, although in practice the Council may be investing on a shorter term basis depending on operational advice of the Council's treasury management adviser.*

Group Limits - For institutions within a banking group, the Council executes a limit of 1.5 times the individual limit of a single bank within that group.

arlingclose

Appendix E – Non-Specified Investments

Instrument	Maximum maturity	Max % of portfolio	Capital expenditure?	Example
Call accounts, term deposits with banks, building societies which do not meet the specified investment criteria (on advice from TM Advisor and Council from s.151 officer)	3 months	30%	No	
CD's and other negotiable instruments	5 years	30%		
Local Authorities	5 years	30%		
Deposits with registered providers	2 years	30%	No	
Gilts	10 years	30%	No	
Bonds issued by multilateral development banks	5 years	30%	No	*EIB Bonds, Council of Europe Bonds etc.*
Sterling denominated bonds by non-UK sovereign governments	5 years	30%	No	
Money Market Funds and Collective Investment Schemes	On notice	30%	No	*Investec Target Return Fund; Elite Charteris Premium Income Fund; LAMIT; M&G Global Dividend Growth Fund*
Corporate and debt instruments issued by corporate bodies purchased	5 years	30%	No	

from 01/04/12 onwards				
Collective Investment Schemes (pooled funds) which do not meet the definition of collective investment schemes in SI 2004 No 534 or SI 2007 No 573	These funds do not have a defined maturity date	30%	Yes	*Way Charteris Gold Portfolio Fund; Lime Fund*

Appendix F – MRP Statement 2013/14

CLG's Guidance on Minimum Revenue Provision (issued in 2010) places 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.

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.

MRP in 2013/14: Options 1 and 2 may be used only for supported (i.e. financing costs deemed to be supported through Revenue Support Grant from Central Government) Non-HRA capital expenditure funded from borrowing. Methods of making prudent provision for unsupported Non-HRA capital expenditure include Options 3 and 4 (which may also be used for supported Non-HRA capital expenditure if the Council chooses). There is no requirement to charge MRP in respect of HRA capital expenditure funded from borrowing.

The MRP Statement will be submitted to Council before the start of the 2013/14 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.

The Council will apply Option 1 respect of supported Non-HRA capital expenditure funded from borrowing and Option 3 in respect of unsupported Non-HRA capital expenditure funded from borrowing. For capital grants and contributions the Council will apply 4% or 1/25th per year on a straight line basis.