# Treasury Management Strategy Statement, Annual Investment Strategy and Prudential Indicators 2013-14 to 2015-16

## 1. Introduction

1.1 The treasury management service is an important part of the overall financial management of the Council's affairs. Councils may borrow or invest for any purpose relevant to its functions, under any enactment, or for the purpose of the prudent management of its financial affairs. Prudential indicators consider the affordability and impact of capital expenditure decisions and the treasury service covers the effective funding of these decisions.

1.2 The Council's treasury activities are strictly regulated by statutory requirements and the CIPFA TM Code. This Council adopted the CIPFA TM Code on 13 June 2002, and as a result adopted a revised Treasury Management Policy Statement (Council: 9 February 2012). This adoption meets the requirement of one of the treasury management prudential indicators.

1.3 The treasury management policy requires an annual strategy to be reported to the Executive and to Council outlining the expected treasury activity for the forthcoming three years, a report after the first six months and a further report after the year-end, to set out the actual activity during the period.

1.4 A key requirement of this report is to explain the risks associated with the treasury management service and the management of those risks.

1.5 The CIPFA Prudential Code and Treasury Management Code of Practice require local authorities to set Prudential and Treasury Indicators. These indicators are shown in the relevant sections as listed below in paragraph 1.7.

1.6 The objectives of the prudential code, and the indicators calculated in accordance with it, are to provide a framework for local authority capital finance that will ensure:

- capital expenditure plans are affordable
- all external borrowing and other long term liabilities are within prudent and sustainable levels
- treasury management decisions are taken in accordance with professional good practice and
- in taking the above decisions the Council is accountable by providing a clear and transparent framework.

1.7 This strategy covers:

- the current and projected treasury position including capital expenditure implications
- the Council's borrowing and debt strategy
- the Council's investment strategy (in compliance with the government guidance), including specific limits on treasury activities
- the expected movement in interest rates

- the annual Minimum Revenue Provision (MRP) Statement
- treasury performance indicators
- other items.

## 2. Balance Sheet and Treasury Position

**Current and Projected Balance Sheet and Treasury Position Prudential Indicator**

2.1 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The CFR is calculated from the amounts held in the balance sheet relating to capital expenditure and its financing. This, along with the Council's balances and reserves are the core drivers of the Council's treasury management activities.

2.2 A borrowing requirement represents the cumulative capital expenditure of the Council that has not been financed (from capital receipts, capital grants and contributions, revenue or reserves) and is, therefore, our level of debt. To ensure that General Fund debt will ultimately be financed, local authorities are required to make a Minimum Revenue Provision (MRP) from the General Fund revenue budget each year. The length of the repayment period depends on the asset being financed which is stated in the MRP statement set by the Council as part of this strategy document. There is no requirement to make MRP on Housing Revenue Account (HRA) debt.

2.3 Market conditions, interest rate expectations and credit risk considerations will all influence the Council's strategy in determining the borrowing and investment activity against the underlying balance sheet position.

2.4 The Council is able to borrow funds in excess of the current level of its CFR up to the projected CFR level in 2015-16. The Council is only likely to borrow in advance of need if it feels the benefit of borrowing at interest rates now compared to where they are expected to be in future, outweighs the current cost and risk associated with investing the proceeds until the borrowing is actually required.

2.5 The table below shows how the core components of the balance sheet (borrowing and reserves) determine the Council's net borrowing or investment capacity.

| Guildford Borough Council | | | | | |
|---|---|---|---|---|---|
| Gross to Net Borrowing Requirement (Projections) | | | | | |
| | 31-Mar-12<br>£'000 | 31-Mar-13<br>£'000 | 31-Mar-14<br>£'000 | 31-Mar-15<br>£'000 | 31-Mar-16<br>£'000 |
| Gross CFR | 200,308 | 208,102 | 224,451 | 227,274 | 227,585 |
| Less: Deferred Liabilities (nominal value) | 0 | 0 | 0 | 0 | 0 |
| **Borrowing CFR** | **200,308** | **208,102** | **224,451** | **227,274** | **227,585** |
| Less: External Borrowing (nominal value) | (194,545) | (194,315) | (194,085) | (193,855) | (193,626) |
| **Gross Borrowing Requirement/Internal Borrowing** | **5,763** | **13,787** | **30,366** | **33,419** | **33,959** |
| Less: Usable Reserves | (60,708) | (59,906) | (62,559) | (57,638) | (65,746) |
| **Net Borrowing Requirement/ (Internal Borrowing Capacity)** | **(54,945)** | **(46,119)** | **(32,193)** | **(24,219)** | **(31,787)** |

| General Fund Balance Sheet Position | | | | | |
|---|---|---|---|---|---|
| Gross to Net Borrowing Requirement (Projections) | | | | | |
| | 31-Mar-12<br>£'000 | 31-Mar-13<br>£'000 | 31-Mar-14<br>£'000 | 31-Mar-15<br>£'000 | 31-Mar-16<br>£'000 |
| Gross CFR | 3,644 | 11,438 | 27,787 | 30,609 | 30,921 |
| Less: Deferred Liabilities (nominal value) | 0 | 0 | 0 | 0 | 0 |
| **Borrowing CFR** | **3,644** | **11,438** | **27,787** | **30,609** | **30,921** |
| Less: External Borrowing (nominal value) | 0 | 0 | 0 | 0 | 0 |
| **Gross Borrowing Requirement/Internal Borrowing** | **3,644** | **11,438** | **27,787** | **30,609** | **30,921** |
| Less: Usable Reserves | (40,951) | (31,027) | (32,863) | (26,177) | (25,708) |
| **Net Borrowing Requirement/ (Internal Borrowing Capacity)** | **(37,307)** | **(19,589)** | **(5,076)** | **4,432** | **5,213** |

| HRA Balance Sheet Position | | | | | |
|---|---|---|---|---|---|
| Gross to Net Borrowing Requirement (Projections) | | | | | |
| | 31-Mar-12<br>£'000 | 31-Mar-13<br>£'000 | 31-Mar-14<br>£'000 | 31-Mar-15<br>£'000 | 31-Mar-16<br>£'000 |
| Gross CFR | 196,664 | 196,664 | 196,664 | 196,664 | 196,664 |
| Less: Deferred Liabilities (nominal value) | 0 | 0 | 0 | 0 | 0 |
| **Borrowing CFR** | **196,664** | **196,664** | **196,664** | **196,664** | **196,664** |
| Less: External Borrowing (nominal value) | (194,545) | (194,315) | (194,085) | (193,855) | (193,626) |
| **Gross Borrowing Requirement/Internal Borrowing** | **2,119** | **2,349** | **2,579** | **2,809** | **3,038** |
| Less: Usable Reserves | (19,757) | (28,879) | (29,696) | (31,461) | (40,038) |
| **Net Borrowing Requirement/ (Internal Borrowing Capacity)** | **(17,638)** | **(26,530)** | **(27,117)** | **(28,652)** | **(37,000)** |

2.6 The table shows the General Fund CFR is increasing because of the impact of financing the capital programme budget in future years. The CFR figure includes the capital bids made for inclusion in the programme from 2013-14 to 2017-18 that are the subject of a separate report on this agenda. These bids are still to be considered by the Executive and approved by Council. Any changes to the bids will change the figures above.

2.7 The General Fund balances and reserves are decreasing, reflecting estimated expenditure profiles. The table above assumes the General Fund will use its own reserves (internally borrow) until 2013-14. The gross borrowing requirement is higher than the usable reserves at 31 March 2015 and the Council will need to decide to either borrow externally or borrow internally from the HRA if there are sufficient reserves to do so.

2.8 The HRA CFR includes £192.4 million in relation to the HRA debt settlement and £4.2 million of existing external and internal borrowing. The CFR is not reducing because there is no statutory MRP requirement on the HRA. The Council could reduce the HRA CFR by making a Voluntary Revenue Provision (VRP) to revenue from capital receipts or other usable reserves. The Council took the decision to take maturity loans for the HRA debt settlement, and are therefore not repaying any loan principal throughout the life of the loans. This decision was made to give maximum flexibility over HRA reserves and will be reviewed regularly.

2.9 The level of reserves is increasing because the interest on the external loans is lower than the amount that was paid out in HRA subsidy prior to the changes in housing finance. This balance is being placed in a new build reserve to fund future development outside this time period.

**Gross Debt and the Capital Financing Requirement Prudential Indicator**

2.10 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 Council will ensure that debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional increases to the CFR for the current and next two financial years.

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

2.12 The Chief Financial 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.

2.13 It can be seen from the table below that the Council’s current and assumed external borrowing is lower than the Council’s gross CFR which means we are internally borrowing and are not borrowing in advance of need.

| | March 12 Actual £'000 | March 13 Projected Outturn £'000 | March 14 Estimate £'000 | March 15 Estimate £'000 | March 16 Estimate £'000 |
|---|---|---|---|---|---|
| General Fund CFR | 3,644 | 11,438 | 27,787 | 30,609 | 30,921 |
| HRA CFR | 196,664 | 196,664 | 196,664 | 196,664 | 196,664 |
| **Total CFR** | **200,308** | **208,102** | **224,451** | **227,274** | **227,585** |
| Gross external borrowing | (194,545) | (194,315) | (194,085) | (193,855) | (193,626) |
| **Net (external) / internal borrowing position** | **5,763** | **13,787** | **30,366** | **33,419** | **33,959** |

**Capital Expenditure Prudential Indicator**

2.14 It is a requirement of the Prudential Code to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax for General Fund capital expenditure and HRA rent levels for HRA capital expenditure.

2.15 The Council's capital expenditure plans are summarised below. Capital expenditure is unsupported by the Government (Government grant is not available) and it will, therefore, be financed from the Council's own resources. Any capital expenditure, which cannot be immediately funded from Council resources, will mean the Council has an underlying need to borrow (as shown above in the CFR projections in paragraph 2.5).

2.16 An annual MRP charge, spread over the life of the asset, is payable when capital expenditure increases the CFR. If external borrowing is taken out there is also an annual interest charge. If the Council uses its own resources, the revenue cost is limited to the loss of interest which would have been received if the money had been invested. At current rates of interest, the cost of borrowing would be significantly higher than the income forgone when capital receipts are used.

2.17 The Prudential Code requires the Council to undertake a financial options appraisal, to demonstrate how it has arrived at its decision in the use of its resources relating to the capital programme (for example, borrow internally, borrow externally or lease).

2.18 The following table details capital expenditure and sources of finance. The detail behind the General Fund capital figures in this table can be found in the capital programme report elsewhere on this agenda.

| CAPITAL EXPENDITURE SUMMARY | 2012-13 Approved £000 | 2012-13 Outturn £000 | 2013-14 Estimate £000 | 2014-15 Estimate £000 | 2015-16 Estimate £000 |
|---|---|---|---|---|---|
| **General Fund Capital Expenditure (Unsupported Expenditure)** | | | | | |
| - Main Programme | 3,796 | 12,775 | 23,912 | 5,733 | 1,705 |
| - Future year Provisional schemes | 0 | 0 | 0 | 0 | 0 |
| - Schemes funded by reserves | 3,246 | 3,466 | 2,253 | 781 | 625 |
| - S106 Projects | 158 | 1,397 | 369 | 265 | 20 |
| - Housing Grants (General Fund) | 600 | 600 | 600 | 600 | 600 |
| - Affordable Housing (General Fund) | 1,684 | 1,766 | 1,756 | 803 | 550 |
| **Total Expenditure** | **9,484** | **20,003** | **28,890** | **8,182** | **3,500** |
| Financed by : | | | | | |
| Capital Receipts | (5,036) | (2,340) | (7,800) | (2,852) | (910) |
| Capital Grants/Contributions | (782) | (2,076) | (1,572) | (653) | (360) |
| Capital Reserves/Revenue | (3,266) | (7,835) | (2,694) | (681) | (525) |
| Borrowing | (400) | (7,753) | (16,824) | (3,996) | (1,705) |
| **Financing - Totals** | **(9,484)** | **(20,003)** | **(28,890)** | **(8,182)** | **(3,500)** |
| **Housing Revenue Account Capital Expenditure** | | | | | |
| **Total Expenditure** | **7,925** | **7,435** | **15,025** | **14,236** | **7,604** |
| Financed by : | | | | | |
| - Capital Receipts | (1,650) | (450) | (250) | (250) | (250) |
| - Capital Reserves/Revenue | (6,275) | (6,985) | (14,775) | (13,986) | (7,354) |
| **Financing - Totals** | **(7,925)** | **(7,435)** | **(15,025)** | **(14,236)** | **(7,604)** |

2.19 The figures above are based on the current General Fund capital programme and the capital bids detailed elsewhere on this agenda.

2.20 Anticipated expenditure for the year is higher than budgeted because a number of projects included in the 2011-12 programme are now expected to be carried out in 2012-13. Expenditure increases in 2013-14 because a number of provisional schemes are scheduled, for example, the cost of increasing the number of car parking spaces in the Borough and the approved Garden Waste and Recycling scheme.

**Incremental Impact of Capital Investment Decisions Prudential Indicator**

2.21 This is an indicator of affordability and shows the impact of approved capital expenditure (as summarised in the above table) on Council Tax and Housing Rent levels.

2.22 The incremental impact forecasts the revenue budget implication arising from the capital programme, excluding financing costs. The calculation is the loss of interest on funds being used for the capital programme, plus any ongoing revenue implications over the Council tax base.

2.23 Capital investment decisions do not impact on the weekly housing rents as the Council sets its housing rents in line with the policy laid down by the CLG. There is also no variation to Council Tax once it has been set.

| | 2012-13 Approved £ | 2012-13 Outturn £ | 2013-14 Estimate £ | 2014-15 Estimate £ | 2015-16 Estimate £ |
|---|---|---|---|---|---|
| Cost of Capital Programme on Council Tax - Band D | 0.75 | 3.11 | 5.22 | 1.54 | 0.73 |
| Cost of Housing Capital Programme Weekly Housing Rents | 0.14 | 0.27 | 0.29 | 0.56 | 0.34 |

2.24 The table shows that the impact of the 2012-13 General Fund approved capital programme is higher than originally estimated, due to total expenditure that was originally planned for 2011-12 was not spent and is now anticipated to be spent in 2012-13, and new schemes or supplementary estimates totalling £15.2 million during 2012-13. The impact increases in 2013-14 as a result of higher capital expenditure being anticipated and then reduces in future years as there are fewer schemes in the programme.

2.25 For the HRA the 2012-13 impact is more or less the same as estimated but increases slightly in future years as budgeted expenditure increases.

2.26 The approved indicators for 2012-13 were calculated using a lower investment return than the current outturn, which has increased the cost. The costs in future years use the estimated weighted average investment return used to calculate the investment interest estimates.

**Ratio of Financing Costs to Net Revenue Stream Prudential Indicator**

2.27 This is an indicator of affordability and demonstrates the revenue implications of capital expenditure by highlighting the proportion of the revenue budget required to meet the financing costs associated with capital spending. Financing costs include interest on borrowing, MRP, premium or discount on loans repaid early, investment income and depreciation and impairment where it is a real charge. Depreciation and impairment are not a real charge to the General Fund but have been to the HRA since April 2012.

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

2.29 The net revenue stream for the General Fund is the total budget requirement and for the HRA is total income.

2.30 The estimate for interest payments on external debt for the HRA in 2012-13 was £8.7 million with an outturn of £5.1 million. Interest receipts for 2012-13 were estimated to be £808,640 and the projected outturn is £767,140. Interest receipts are expected to be lower than budgeted because investment rates have been slowly reducing and are at an all time low.

2.31 The estimates of financing costs include current commitments and the proposals in the budget report. Where the figures are negative it means that interest receivable by the Council is higher than interest payable on the financing.

| | 2012-13 Approved | 2012-13 Outturn | 2013-14 Estimate | 2014-15 Estimate | 2015-16 Estimate |
|---|---|---|---|---|---|
| General Fund | -3.98% | -1.95% | 1.86% | 8.47% | 10.18% |
| HRA | 0.10% | 33.92% | 33.71% | 33.98% | 33.70% |

2.32 The General Fund approved estimate for 2012-13 included a lower amount of investment interest payable to the HRA on its reserves because the interest rate budgeted for was based on the HRA subsidy calculation (7-day LIBID) and now the HRA will receive interest based on the actual average investment rate achieved in the year, which has increased the amount payable from the General Fund. Investment income is lower than budgeted, as explained in paragraph 2.30, and a lower amount of MRP will be charged because the budget was based on vehicles being financed from internal borrowing but this expenditure did not happen. Instead internal borrowing was taken for G Live expenditure which has a longer useful life and therefore attracts a lower MRP each year.

2.33 The estimates for the General Fund from 2013-14 increase because financing costs, mainly MRP, exceed investment returns.

2.34 HRA estimated outturn for 2012-13 is substantially higher than the approved indicator because the interest costs of the debt taken on for HRA self financing was not included in the approved indicator and depreciation costs are included for the first time, as explained in paragraph 2.26.

## 3. Borrowing and Debt Strategy

3.1 The Council has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy and practice. Overall borrowing could 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.

3.2 The Council will adopt a flexible approach to its borrowing and the following issues will be considered when taking on the debt:

- affordability
- interest rate and refinancing risk
- borrowing source
- HRA business plan
- benefit of using the Council’s own resources

3.3 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 (see the interest rate forecast in **Appendix 3**). 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 interest paid on the borrowing and that earned on the investment. The cost of carry is likely to be an issue until at least 2016. As borrowing is often for longer 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.

3.4 As indicated in the table in paragraph 2.5 (balance sheet summary analysis), the Council has an overall gross borrowing requirement and is expected to need to borrow up to £11.4 million in 2012-13. There is currently enough capacity within the Council's usable reserves to internally borrow and this remains the Council's favoured borrowing option at the present time.

**Sources of Borrowing and Portfolio implications**

3.5 In conjunction with its treasury advisor, the Council will keep under review the following borrowing sources:

- Internal resources
- PWLB
- Local Authorities
- Commercial Banks
- European Investment Bank (the EIB will only lend up to 50 per cent towards the funding of a specific project and needs to meet the EIB's specific criteria)
- Capital Markets (stock issues, commercial paper and bills)
- Structured finance
- Leasing

3.6 On 20 October 2010, following the Comprehensive Spending Review (CSR) announcement, Circular 147 was issued which increased the cost of new local authority fixed rate loans from the PWLB to one per cent above the cost of the Government's borrowing. Despite this the PWLB remains an attractive source of borrowing, due to the transparency and control that its facilities continue to provide. The types of PWLB borrowing that are considered appropriate are:

- variable rate borrowing
- Equal Instalments of Principal (EIP)
- Annuity loans
- Maturity loans

3.7 The cost of carry would result in an increased reliance upon shorter dated and variable rate borrowing to minimise the cost of carry in the short term. 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 change in the spread by 0.50 per cent will trigger an immediate and formal review of the borrowing strategy to determine whether the exposure to shorter dated and variable rates is maintained or altered.

**Debt Rescheduling**

3.8 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.

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

- 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

3.10 Borrowing and rescheduling activity will be reported to the Executive in the annual treasury management report and the regular treasury management reports presented to Councillors via the Treasury Management Panel and Wey Ahead.

3.11 There is a requirement under the Prudential Code for borrowing limits to be set.

**Actual External Debt Prudential Indicator**

3.12 This indicator shows the actual external debt for the Council and is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing (short and long term) plus other long term liabilities (for example finance leases). It is presented in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

| Actual External Debt | March 11 £000 | March 12 £000 |
|---|---|---|
| Borrowing | 2,300 | 194,505 |
| Other Long Term Liabilities | 114 | 0 |
| **Total** | **2,414** | **194,505** |

3.13 The table shows that the Council had external debt as at 31 March 2012 of £194.5 million. It is all related to the HRA.

**HRA Limit on Indebtedness**

3.14 This indicator compares the actual debt of the HRA to the debt cap imposed by the Government.

| HRA Limit on Indebtedness | 2012-13 Outturn £000 | 2013-14 Estimate £000 | 2014-15 Estimate £000 | 2015-16 Estimate £000 |
|---|---|---|---|---|
| HRA CFR | 196,664 | 196,664 | 196,664 | 196,664 |
| HRA Debt Cap (as set by CLG) | 196,665 | 196,665 | 196,665 | 196,665 |
| **Difference** | **(1)** | **(1)** | **(1)** | **(1)** |

3.15 The table shows there is a small amount of headroom on the HRA CFR. The Council will need to review its HRA CFR regularly, in line with its balances and reserves, to ensure that should the need for increasing the CFR arise, there are balances and reserves to fund the capital expenditure to ensure the debt cap is not breached.

### The Operational Boundary Prudential Indicator

3.16 The Operational Boundary is a monitoring indicator that shows the most likely, prudent but not worst case scenario debt level on an operational level. This links to the Council's capital programme, estimated CFR and cash flow requirements. It represents the current debt portfolio and a maximum amount of assumed temporary borrowing which may be required during the year but it is not a limit of total borrowing for the Council – this limit is the Authorised Limit (see below).

| **Operational Boundary of External Debt** | **2012-13 Approved £000** | **2013-14 Estimate £000** | **2014-15 Estimate £000** | **2015-16 Estimate £000** |
|---|---|---|---|---|
| Borrowing - General Fund | 17,710 | 43,625 | 46,845 | 45,805 |
| Borrowing - HRA | 197,430 | 196,665 | 196,665 | 196,665 |
| Other Long Term Liabilities | 0 | 0 | 0 | 0 |
| **Total** | **215,140** | **240,290** | **243,510** | **242,470** |

3.17 The 2013-14 General Fund estimate is calculated by taking the estimated CFR (£28 million) plus an allowance of headroom for cash movements. The HRA operational boundary is limited to the HRA debt cap.

### The Authorised Limit Prudential Indicator

3.18 The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit and should not be breached.

3.19 This limit is the maximum amount of external borrowing that can be outstanding at any one time during the financial year. The limit, which is expressed gross of investments, is consistent with the Council's existing commitments, its proposals for capital expenditure and financing and its approved treasury policy and strategy. It is calculated as the Operational Boundary plus a contingency for emergencies.

| **Authorised Limit for External Debt** | **2012-13 Approved £000** | **2013-14 Estimate £000** | **2014-15 Estimate £000** | **2015-16 Estimate £000** |
|---|---|---|---|---|
| Borrowing - General Fund | 45,710 | 145,625 | 151,045 | 151,005 |
| Borrowing - HRA | 197,430 | 196,665 | 196,665 | 196,665 |
| Other Long Term Liabilities | 0 | 0 | 0 | 0 |
| **Total** | **243,140** | **342,290** | **347,710** | **347,670** |

3.20 The General Fund authorised debt level gives headroom for significant cash flow movements, over the operational boundary, for example Council Tax not being received on the correct day. The HRA limit is set as the debt cap imposed by Government.

3.21 The Authorised Limit is monitored on a daily basis against all external debt items on the balance sheet (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.

3.22 The authorised limit for 2013-14 has been increased to reflect the possibility of expenditure on regeneration schemes within the borough. Should the Council consider this possibility, it will report to the Executive in due course.

3.23 The Chief Financial Officer has delegated authority, within the total limit for any individual year, to agree movement between the separately agreed limits for borrowing and other long term liabilities. Decisions will be based on the outcome of financial options appraisal and best value considerations. Any movement between these separate limits will be reported to Council.

**Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure Treasury Indicators**

3.24 These limits allow the Council to manage the extent to which the revenue budget is exposed to changes in interest rates. The limit allows for the use of variable rate debt to offset exposure to changes in short term rates on investments.

3.25 The limits 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 strategy.

| | **2012-13 Approved** | **2013-14 Estimate** | **2014-15 Estimate** | **2015-16 Estimate** |
|---|---|---|---|---|
| **Debt:** | | | | |
| Upper Limit on fixed interest rates | 100% | 100% | 100% | 100% |
| Upper Limit on variable interest rates | 75% | 21% | 21% | 21% |
| Limits on fixed interest rates (£000) | | 281,990 | 287,010 | 288,320 |
| Limits on variable interest rates (£000) | | 60,000 | 60,000 | 60,000 |
| **Investments:** | | | | |
| Upper Limit on fixed interest rates | 100% | 100% | 100% | 100% |
| Upper Limit on variable interest rates | 75% | 80% | 83% | 83% |
| Limits on fixed interest rates (£000) | | (94,100) | (65,200) | (64,900) |
| Limits on variable interest rates (£000) | | (75,650) | (53,990) | (53,800) |
| **Net Debt:** | | | | |
| Upper Limit on fixed interest rates | 100% | 109% | 97% | 97% |
| Upper Limit on variable interest rates | 75% | -9% | 3% | 3% |
| Limits on fixed interest rates (£000) | | 187,890 | 221,810 | 223,420 |
| Limits on variable interest rates (£000) | | (15,650) | 6,010 | 6,200 |

3.26 These limits are based on the current position, with allowances for known changes. They are operational working limits not absolute limits that cannot be breached, and are designed to help reduce the level of interest rate risk in the portfolio.

3.27 The table shows the Council had set a limit for 2012-13 to allow all of its borrowing on a fixed rate basis, which could be from one to 50 years, thereby having stability in the portfolio. At the time the 2012-13 prudential indicators were approved, the Council did not know its profile for the HRA reform debt and wanted to allow maximum flexibility for the portfolio. In addition, only upper limit percentages were set because of the uncertainty of the HRA debt settlement.

3.28 Future years' estimates are linked to the current debt portfolio, adjusted for any potential borrowing linked to the CFR projections. Investment limits are based on the maximum level of cash the Council may have during the year. The table allows all debt and investments to be on a fixed rate of interest, 21 per cent of the debt portfolio and 80 per cent of investments to be on a variable rate in 2013-14. The net debt position shows a negative position for variable rate as the limit for variable rate investments is higher than the level of variable rate debt.

3.29 By having a smaller proportion of debt on a variable rate basis the Council is limiting its exposure to uncertain future interest rates on its debt. The proportion of actual fixed and variable debt will depend upon the total level of debt the Council has and how the mix suits the Council's financial plans.

**Maturity Structure of Fixed Rate Borrowing Treasury Indicator**

3.30 The limits in the following table are set to protect against excessive exposure to volatility in interest rates when refinancing maturing debt in any one period, and in particular in the course of the next ten years. It highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

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

| Maturity Structure of fixed borrowing | | | | | | |
|---|---|---|---|---|---|---|
| | 2013-14 | | 2014-15 | | 2015-16 | |
| | Lower | Upper | Lower | Upper | Lower | Upper |
| Under 12 months | 0% | 0.15% | 0% | 0.15% | 0% | 0.17% |
| 1 year to 2 years | 0% | 0.15% | 0% | 0.15% | 0% | 0.17% |
| 2 years to 5 years | 0% | 0.46% | 0% | 0.46% | 0% | 0.50% |
| 5 years to 10 years | 0% | 0.46% | 0% | 7.02% | 0% | 7.52% |
| 10 years to 20 years | 0% | 60.29% | 0% | 53.68% | 0% | 50.34% |
| 20 years to 30 years | 0% | 38.48% | 0% | 38.54% | 0% | 41.31% |
| 30 years to 40 years | 0% | 0.00% | 0% | 0.00% | 0% | 0.00% |
| 40 years to 50 years | 0% | 0.00% | 0% | 0.00% | 0% | 0.00% |

3.32 This indicator shows the profile of existing borrowing maturing in each time period and makes no allowance for new borrowing.

## 4. Investment Strategy

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

4.2 The Council's general policy is to invest its surplus funds prudently. The Council's investment priorities, in accordance with CLG requirements, are:

- security of the invested capital
- liquidity of the invested capital

- an optimum yield which is commensurate with security and liquidity

4.3 The procedure of borrowing purely to invest is unlawful, although borrowing for short term cash flow requirements is permitted.

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

4.5 The Arlingclose interest rate forecast continues with its theme of the last few years in that interest rates will remain low for even longer. The forecast is for official UK interest rates to remain at 0.50 per cent until 2016 given the stagnant 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 within the Eurozone, and that resolution requires a 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.

4.6 The economic and interest rate forecast provided by Arlingclose is shown at **Appendix 3**. The Council will reappraise its strategies from time to time in response to evolving economic, political and financial events.

4.7 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.

4.8 In order to diversify an investment portfolio largely invested in cash, investments will be placed with approved investment counterparties over a range of maturity periods. To ensure prudent diversification, maximum investment levels will be set for each counterparty.

4.9 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 paragraph 4.13, the Chief Financial Officer has discretion to make investments with counterparties that do not meet the specified criteria on advice from the Council’s treasury management advisors.

**Types of Investment**

4.10 Investments are categorised as “Specified” or “Non-Specified” within the investment guidance issued by the CLG.

4.11 Specified investments are sterling denominated investments with a maximum maturity of one year. They also meet the high credit quality standard as determined by the Council and are not deemed capital expenditure investments under Statute.

4.12 Non Specified investments are, effectively, everything else. They may be for periods exceeding one year or may have accounting restrictions attached to them, for example, are deemed capital expenditure investments. Any investment that counts as capital expenditure would only be appropriate for a small proportion of our investment portfolio.

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

| **Investment** | **Specified** | **Non-Specified** | **Capital Expenditure** |
|---|---|---|---|
| Term deposits with banks and building societies | ✓ | ✓ | No |
| Term deposits with other UK local authorities | ✓ | ✓ | No |
| Investments with Registered Providers (Housing Associations) | ✓ | ✓ | No |
| Certificates of deposit, and other negotiable instruments with banks and building societies | ✓ | ✓ | No |
| Gilts | ✓ | ✓ | No |
| Treasury Bills (T-Bills) | ✓ | × | No |
| Bonds issued by Multilateral Development Banks (e.g. EIB Bonds, Council of Europe Bonds) | ✓ | ✓ | No |
| Local Authority Bills | ✓ | × | No |
| Commercial Paper | ✓ | × | No |
| Corporate Bonds | ✓ | ✓ | No |
| AAA rated Money Market Funds | ✓ | × | No |
| Other Specified Money Market and Collective Investment Schemes (e.g. Investec target return fund, CCLA LAMIT property fund, Payden & Rygel).<br><br>Non Specified Collective Investment Schemes (pooled funds) that do not meet the definition of collective investment schemes in SI 2001 no 534 or SI 2007 no 573 | ✓ | ✓ | Specified = No<br><br>Non Specified = yes |
| Debt Management Account Deposit Facility | ✓ | × | No |
| Investments with other organisations:<br>• Bank falling below criteria specified, for example Co-op and Close Brothers<br>• Small and Medium Enterprises | × | ✓ | No<br><br>Yes / No: depending on the nature of the transaction with the third party |

4.14 Investments with Registered Providers (RP's) have been included as specified and non-specified investments for 2013-14. The Council currently does not invest in RP's and should the Council consider any investments with RP's, they will be analysed on an individual basis and discussed with the Council's treasury management advisors before investing.

4.15 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 advisor will be sought (where available) before any investment decision is made.

4.16 The Council's investments for liquidity purposes consist of call accounts, money market funds, notice accounts and fixed investments which mature in line with anticipated cash flow requirements.

4.17 The Council's core balances are invested longer term, up to five years, in instruments such as EIB bonds, Payden & Rygel sterling investment fund, Investec target return fund which is a riskier fund and is viewed over a five year period because of its volatility, and CCLA Property Investment Fund, also to be viewed over a five year time horizon. In house investments are made with reference to the outlook for the UK Base Rate and Money Market Rates.

4.18 Money market funds (MMFs) will be utilised but good treasury management prevails and whilst MMFs provide good diversification, the Council will also seek to diversify any exposure by utilising at least two MMFs. The Council will restrict its exposure to MMFs with a maximum level of 50 per cent of its total investments invested in MMFs and will not exceed 0.50 per cent of the net asset value of each MMF or two per cent for Government MMFs.

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

**Credit Risk Treasury Indicator**

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

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

- published credit ratings for financial institutions and its sovereign **(minimum long term rating of A- or equivalent for counterparties; AA+ or equivalent for non-UK sovereigns)**. (see **Appendix 2** for credit rating equivalents and definitions). The Council has regard to the ratings issued by all three main agencies – Fitch, Moody's and Standard & Poor's.
- Credit Default Swaps (where quoted)
- economic fundamentals, such as a country's net debt as a percentage of its GDP
- sovereign support mechanisms
- share prices (where available)
- corporate developments, news, articles, market sentiment and momentum
- subjective overlay – or, put more simply, common sense.

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

4.23 The only indicators with prescriptive values are credit ratings. They are an important element of assessing credit risk but are not the sole feature in the Council's assessment of counterparty credit risk. The other indicators of creditworthiness, listed above, are considered in relative rather than absolute terms. The Council only sets a limit for long term credit ratings (and not short term ratings) because it is the long term rating that is the driver for market sentiment and is used for gaining access to funds in the market.

4.24 The countries and institutions that meet the criteria for investments are included in **Annex A**.

4.25 An institution that meets the credit criteria above may be suspended during the year, but institutions not meeting the criteria will not be added.

**The Council's Banker**

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

**Externally Managed Funds**

4.27 The Council has evaluated the use of Pooled Funds, in conjunction with the Council's treasury management advisors, and have determined the appropriateness of their use within the investments 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.

4.28 The Council currently invests in two pooled funds – the Investec target return fund and the Payden & Rygel sterling reserve fund. The performance and continued suitability in meeting the Council's investment objectives of the funds will be regularly monitored.

4.29 The Council has committed £5 million into the CCLA LAMIT property investment fund, as agreed by the Executive on 8 November 2012. At the time of writing this report, the investment is committed but not yet invested.

**Policy on the use of Financial Derivatives**

4.30 Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (for example interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (for example 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 (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.

4.31 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 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.

4.32 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.

4.33 The Council does not currently use derivatives and will only do so after seeking expert guidance, a legal opinion and ensuring officers have the appropriate training for their use.

**Investment Activity**

4.34 The Chief Financial Officer, under delegated authority, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators.

4.35 All investment activity will comply with the accounting requirements of the local authority SORP.

4.36 The Council's current, and projected, investment portfolio is:

| | March 12 Actual £'000 | % at Mar 2012 | March 13 Projected Outturn £'000 | March 14 Estimate £'000 | March 15 Estimate £'000 | March 16 Estimate £'000 |
|---|---|---|---|---|---|---|
| **External Borrowing (cumulative)** | 194,505 | | 202,390 | 220,034 | 224,052 | 225,757 |
| IFRS Long Term Liabilities | | | | | | |
| Finance Leases | 0 | | 0 | 0 | 0 | 0 |
| **Total Gross External Debt** | **194,505** | | **202,390** | **220,034** | **224,052** | **225,757** |
| **Investments** | | | | | | |
| Fixed In House > 1 year | 15,330 | 24% | 7,000 | 0 | 0 | 0 |
| Fixed In House < 1 year | 3,000 | 5% | 7,000 | 0 | 0 | 0 |
| Variable (Call/MMF/Notice & Future) | 39,500 | 62% | 46,211 | 27,012 | 21,178 | 20,165 |
| Managed Externally | | | | | | |
| Investec | 4,980 | 8% | 5,040 | 5,294 | 5,347 | 5,401 |
| Payden & Rygel | 1,000 | 2% | 5,000 | 5,000 | 5,000 | 5,000 |
| CCLA Property Fund | 0 | 0% | 0 | 5,000 | 5,000 | 5,000 |
| **Total Investments** | **63,810** | | **70,251** | **42,306** | **36,525** | **35,566** |
| **(Net Borrowing) / Net Investment Position** | **(130,695)** | | **(132,139)** | **(177,728)** | **(187,527)** | **(190,191)** |

4.37 The majority of the Council's in house investments can be classed as low risk, in terms of the counterparties that are invested with. The Investec Target Return fund is a high risk fund as it can lose as well as make money, which is the reason for holding only a small element (eight per cent) of the portfolio in this type of fund. The Payden & Rygel fund is a variable net asset value fund (VNAV) and is more risky that the in house investments, because the value can change, but it not as risky as Investec.

**Upper Limit for total principal sums invested over 364 days Treasury Indicator**

4.38 The purpose of this indicator is to manage the risk inherent in holding investments for longer than 364 days. The maximum level is set to give the necessary flexibility allowing for budgeted level of balances and reserves. This limit is set to be 20 per cent of the maximum anticipated level of the investment portfolio in the year.

| | 2012-13 Approved | 2013-14 Estimate | 2014-15 Estimate | 2015-16 Estimate |
|---|---|---|---|---|
| Upper Limit for total principal sums invested for longer than 364 days | £19m | £19m | £13m | £13m |

## 5. Outlook for Interest Rates

5.1 The economic and interest rate outlook provided by the Council's treasury management advisors is attached in **Appendix 3**. The Council will reappraise its strategy from time to time in response to evolving economic, political and financial events.

5.2 The Council's treasury management advisors central case interest rate forecast has been used for the 2013-14 budget and future projections.

5.3 Base rate is expected to remain at 0.50 per cent for a considerable time – perhaps until December 2016 – and then increase slowly.

## 6. 2013-14 Minimum Revenue Provision Statement (MRP)

6.1 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 MRP 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. MRP only applies to non HRA capital expenditure. There is no requirement to charge MRP in respect of HRA capital expenditure funded from borrowing.

6.2 The four main options are set out below (these do not preclude other prudent methods):

- option 1: Regulatory Method
- option 2: CFR Method
- option 3: Asset Life Method
- option 4: Depreciation Method

6.3 Options 1 and 2 may only be used for supported capital expenditure (expenditure funded through Revenue Support Grant from Central Government). Options 3 and 4 are prudent methods for self financed capital expenditure but may also be used for supported capital expenditure if the Council chooses.

6.4 The MRP Statement must be submitted to Council before the start of the financial year, as is therefore part of this Strategy. If it is proposed to vary the terms of the original MRP Statement during the year, a revised statement will be put to Council at that time.

6.5 For 2013-14 the Council will apply option 4 (depreciation method) for the purchase of vehicles.

6.6 For 2013-14 the Council will apply option 3 (asset life method) for any borrowing offset against expenditure relating to property acquisition (as there is no residual value).

6.7 For any expenditure not yet identified, option 3 will be used for expenditure with no or minimal residual value and option 4 where a residual value can be determined.

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

## 7. Treasury Management Performance Monitoring

7.1 CIPFA advocates the principle that Council's should create appropriate methods by which the performance of their treasury management activities can be measured and recommend that the selection of appropriate measures and benchmarks are set.

7.2 Treasury management activity and Prudential Indicators are monitored on a monthly basis by officers and are reported quarterly to councillors via the *Wey Ahead*. Other monitoring includes:

- the Council will produce an outturn report on its treasury activity no later than 30 September after the end of the financial year end.
- the Treasury Management Panel will meet at key stages during the financial year to review compliance of indicators and performance of treasury activity in the year, review the annual strategy and the annual report.
- the Corporate Improvement scrutiny committee is responsible for the scrutiny of the Council's treasury management activity and practices.

7.3 The Council sets performance indicators to assess the return against the Bank of England base rate on treasury activities over the year. These include the separate monitoring of in-house investments (both longer term and for cash flow purposes) and externally managed funds.

7.4 Performance is also monitored through benchmarking with both CIPFA and other Arlingclose clients. The Council is also a member of the Surrey treasury management officers group who meet twice a year to discuss treasury management issues.

## 8. Other Items

### Balanced Budget Requirement

8.1 The Council complies with the provisions of Section 32 of the Local Government Finance Act 1992 to set a balanced budget.

### Adoption of the CIPFA Treasury Management Code - Prudential Indicator

8.2 The Council approved the adoption of the CIPFA Treasury Management Code at its full Council meeting on 13 June 2002.

8.3 The Council has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices. The treasury management policy was also updated and approved by Council on 9 February 2012.

**Housing Revenue Account Self Financing**

8.4 Central Government completed its reform of the HRA 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 CLG.

8.5 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 requires that Councils present this policy in their treasury management strategy statement.

8.6 On 1 April 2012, the Council adopted a two pool approach to its loan portfolio, where each loan is allocated to either the General Fund or the HRA depending on the purpose of the loan. Interest payable and other costs or income arising from long term loans (e.g. premiums and discounts on early redemption) will be charged or credited to the respective account.

8.7 The HRA is currently internally borrowing from the General Fund. The HRA will be charged interest on the borrowing, at the end of the financial year, at the average investment rate achieved in the year for the Council, adjusted for a credit risk margin.

8.8 The item 8 determination, which controls items that can be charged to the HRA, does not allow impairment losses to be charged; any related losses on the Council's investments will be borne by the General Fund. This remains the case even if all the investments relate to the HRA cash balance. The General Fund should, therefore, be compensated for bearing this risk, and interest earned by the HRA on balances should be adjusted downwards. Officers are considering a method of applying this credit risk, with support by Arlingclose.

**Training**

8.9 CIPFA's Code of Practice requires the Chief Financial Officer to ensure that all Councillors 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.

8.10 Training has been given to the Corporate Improvement Scrutiny Committee and Arlingclose meet from time to time with both the lead Councillor and the Treasury Management panel to explain current issues and performance. The need for training will be reviewed on an ongoing basis and further training will be scheduled as and when required.

8.11 Officer training is undertaken on a regular basis, by attending workshops held by the Council's treasury management advisors, and seminars / conferences held by other bodies, such as CIPFA. On the job training and knowledge sharing for officers covering the daily treasury management tasks are undertaken on a daily basis.

8.12 Those involved in the treasury management activity are either a fully qualified accountant, AAT qualified or working towards a professional accountancy qualification. The Senior

Accountant (Treasury Management and Capital) holds the 'Certificate in International Treasury Management for Public Finance' (CertITM-PF) qualification which is a joint treasury management qualification between the ACT (Association of Corporate Treasurers) and CIPFA.

**Investment Consultants**

8.13 The CLG's Guidance on Local Government investments recommend that the Investment Strategy should detail the use of external consultants, if applicable, and how the quality of the service is controlled:

- the council will use at least two brokers to gather information and place deals where it is financially advantageous compared to direct dealing. The information received will be compared with information from other service providers in the market to gauge its applicability within the Council's strategy.

- the Council has entered into a five year contract, from 1 April 2010, with Arlingclose, a treasury management advisor, who provides the Council with credit, investment and technical advice, economic and interest rate forecasts, workshops and training events, HRA support and debt advice and support tailored to the Council's risk appetite and strategy. Regular contact and quarterly meetings will be held with the advisors to discuss changes on all aspects of treasury management and specifically in relation to the changing requirements of the Council.

APPENDIX 1

Annex A

**Recommended Sovereign and Counterparty List**

| Instrument | Country | Counterparty | Max limit of Investments |
|---|---|---|---|
| Term deposits | UK | DMADF, DMO | No Limit |
| Term deposits / Call accounts | UK | Other UK Local Authorities | No Limit |
| Term deposits / CDs (and other negotiable instruments) / Call accounts / Notice accounts | UK | Counterparties rated at least A- long term | Set under delegation* |
| Term deposits / CDs (and other negotiable instruments) / Call accounts / notice accounts | Non-UK | Counterparties rated at least A- long term in selected countries with a Sovereign Rating of at least AA+ | 15% of total investments per counterparty |
| Investments with organisations which **do not meet** the specified investment criteria | | For example banks falling below the specified criteria and Small and Medium Enterprises | £20 million overall |
| Gilts | UK | DMO | No Limit |
| T-Bills | UK | DMO | No Limit |
| LA Bills | UK | Other UK Local Authorities | No Limit |
| Bonds issued by multilateral development banks | | For example European Investment Bank / Council of Europe / Inter American Development Bank | 50% of total investments |
| AAA rated Money Market Funds (MMFs). | UK / Ireland / Luxembourg domiciled | CNAV MMFs<br>VNAV MMFs (where there is greater than 12 month history of a consistent £1 Net Asset Value) | 50% of total investments and 0.50% of fund size rounded up to nearest £million |
| Other MMFs and CIS. E.g. Payden & Rygel, Investec Short Bond Fund, CCLA LAMIT property fund. | UK / Ireland / Luxembourg domiciled | Pooled Funds which meet the definition of a Collective Investment Scheme per SI 2004 No 534 and subsequent amendments | £25 million |

*The current limit per counterparty is £10 million. Where individual counterparties are in a banking group, the overall limit for that group will be 1.5 times (currently £15 million).

The individual counterparty list is subject to change and a working copy of the list is held with the treasury management procedures notes and TMPs. A copy of the current list is available on request.

It is the Council's policy to use external fund managers for part of its investment portfolio. The fund managers will use both specified and non-specified investments, and are contractually committed to keep to the Council's Investment Strategy. The terms of the fund managers' investment policies are:

| | |
|---|---|
| Objective | The Fund will seek to achieve an absolute return through investment in a combination of pooled UCITS funds. (that is as defined in SI 2004 No 534 and SI 2007 No 573) |
| Permitted Investments.<br><br>Current investments are shown opposite and other investments may be considered. | UCITS* funds, for example:<br><br>Investec Fund Series IV – Target Return (GBP) Fund 'S' Class Shares<br><br>Investec Short Term Bond Fund<br><br>LAMIT property fund<br><br>Payden & Rygel |

* Undertakings for collective investments in transferrable securities

## Glossary

**Affordable Housing Grants –** grants given to Registered Providers to facilitate the provision of affordable housing.

**Authorised Limit** – the maximum amount of external debt at any one time in the financial year

**Bank Rate –** the Bank of England base rate

**Capital Financing Requirement (CFR)** – financing needs of the Council – i.e. the requirement to borrow

**CIPFA** - the Chartered Institute of Public Finance and Accountancy. The institute is one of the leading professional accountancy bodies in the UK and the only one which specialises in the public sector. It is responsible for the education and training of professional accountants and for their regulation through the setting and monitoring of professional standards. Uniquely among the professional accountancy bodies in the UK, CIPFA has responsibility for setting accounting standards for a significant part of the economy, namely local government. CIPFA's members work, in public service bodies, in the national audit agencies and major accountancy firms.

**Cost of Carry** - Costs incurred as a result of an investment position, for example the additional cost incurred when borrowing in advance of need, if investment returns don't match the interest payable on the debt.

**Counterparty –** the organisation the Council is investing with

**Credit Rating –** an assessment of the credit worthiness of an institution

**Creditworthiness** – a measure of the ability to meet debt obligations

**EIP** – Equal Instalments of Principal. A repayment method whereby a fixed amount of principal is repaid with interest being calculated on the principal outstanding

**Finance Lease** - a finance lease is a lease that is primarily a method of raising finance to pay for assets, rather than a genuine rental. The latter is an operating lease. The key difference between a finance lease and an operating lease is whether the lessor (the legal owner who rents out the assets) or lessee (who uses the asset) takes on the risks of ownership of the leased assets. The classification of a lease (as an operating or finance lease) also affects how it is reported in the accounts.

**Gilts –** long term fixed income debt security (bond) issued by the UK Government and traded on the London Stock Exchange

**Housing Grants –** see Affordable Housing Grants

**LIBID** – London Interbank BID Rate – the interest rate at which London banks are willing to borrow from one another

**Minimum Revenue Provision** - the minimum amount which must be charged to an authority's revenue account each year and set aside towards repaying borrowing

**Money Market** - the market in which institutions borrow and lend

**Money Market Rates –** interest rates on money market investments

**Multilateral Investment banks –** International financial institutions that provide financial and technical assistance for economic development

**Non Specified Investments** - all types of investment not meeting the criteria for specified investments.

**Operational Boundary –** the most likely, prudent but not worse case scenario of external debt at any one time

**Pooled Funds –** investments are made with an organisation who pool together investments from other organisations and apply the same investment strategy to the portfolio. Pooled fund investments benefit from economies of scale, which allows for lower trading costs per pound, diversification and professional money management.

**Prudential Code –** a governance procedure for the setting and revising of prudential indicators. Its aim is to ensure, within a clear framework, that the capital investment plans of the Council are affordable, prudent and sustainable and that treasury management decisions are taken in accordance with good practice.

**Prudential Indicators –** indicators set out in the Prudential Code that calculates the financial impact and sets limits for treasury management activities and capital investment

**PWLB** (Public Works Loans Board) - a central government agency which provides long- and medium-term loans to local authorities at interest rates only slightly higher than those at which the Government itself can borrow. Local authorities are able to borrow to finance capital spending from this source

**Reserve Schemes –** category of schemes within the General Fund capital programme that are funded from earmarked reserves, for example the Car Parks Maintenance reserve or Spectrum reserves.

**Sovereign –** the countries the Council are able to invest in

**Specified Investments** - Specified investments are defined as:

a. denominated in sterling;
b. repayable within 12 months of making the investment (or one which the local authority can request repayment within 12 months);
c. not defined as capital expenditure; and
d. made with:
    i. a body (or investment scheme) which has a high credit rating awarded by a credit rating agency;
    ii. the UK government;
    iii. a local authority in England, Wales, Scotland or Northern Ireland; or
    iv. a parish or community council.

**Stable Net Asset Value money market funds** – the principle invested remains at its invested value and achieves a return on investment

**Subsidy Capital Financing Requirement –** the housing capital financing requirement set by the Government for Housing Subsidy purposes

**SWAP Bid** – a benchmark interest rate used by institutions

**Treasury Management** – the management of the Council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risk associated with those activities and the pursuit of optimum performance with those risks.

**Treasury Management Practices** – schedule of treasury management functions and how those functions will be carried out

**Variable Net Asset Value money market funds –** the principle invested may fluctuate below that invested

**Voluntary Revenue Provision** – a voluntary amount charged to an authority's revenue account and set aside towards repaying borrowing.

## Credit Rating Equivalents and Definitions

| | Fitch | Moody's | Standard & Poor's |
|---|---|---|---|
| **Long Term Investment Grade** | AAA | Aaa | AAA |
| | AA+<br>AA<br>AA- | Aa1<br>Aa2<br>Aa3 | AA+<br>AA<br>AA- |
| | A+<br>A<br>A- | A1<br>A2<br>A3 | A+<br>A<br>A- |
| | BBB+<br>BBB<br>BBB- | Baa1<br>Baa2<br>Baa3 | BBB+<br>BBB<br>BBB- |
| **Sub Investment Grade** | BB+<br>BB<br>BB- | Ba1<br>Ba2<br>Ba3 | BB+<br>BB<br>BB- |
| | B+<br>B<br>B- | B1<br>B2<br>B3 | B+<br>B<br>B- |
| | CCC+<br>CCC<br>CCC- | Caa1<br>Caa2<br>Caa3 | CCC+<br>CCC<br>CCC- |
| | CC+<br>CC<br>CC- | Ca1<br>Ca2<br>Ca3 | CC+<br>CC<br>CC- |
| | C+<br>C<br>C- | C1<br>C2<br>C3 | C+<br>C<br>C- |
| | D | | D or SD |

| Fitch | Moody's | Standard & Poor's |
|---|---|---|
| **AAA**<br>Highest credit quality. 'AAA' ratings denote the lowest expectation of credit risk. They are assigned only in the case of exceptionally strong capacity for payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events. | **Aaa**<br>Obligations rated Aaa are judged to be of the highest quality, with minimal credit risk. | **AAA**<br>An obligator rated 'AAA' has extremely strong capacity to meet its financial commitments. 'AAA' is the highest issuer credit rating assigned by Standard & Poors. |
| **AA**<br>Very high credit quality. 'AA' ratings denote expectations of very low credit risk. They indicate very strong capacity for payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events. | **Aa**<br>Obligations rated Aa are judged to be of high quality and are subject to very low credit risk. | **AA**<br>An obligator rated 'AA' has very strong capacity to meets its financial commitments. It differs from the highest rated obligators only to a small degree. |
| **A**<br>High credit quality. 'A' ratings denote expectations of low credit risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings. | **A**<br>Obligations rated A are considered upper-medium grade and are subject to low credit risk. | **A**<br>An obligator rated 'A' has strong capacity to meet its financial commitments but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligators in higher rated categories. |
| **BBB**<br>Good credit quality. 'BBB' ratings indicate that there are currently expectations of low credit risk. The capacity for payment of financial commitments is considered adequate but adverse changes in circumstances and economic conditions are more likely to impair this capacity. This is the lowest investment grade category. | **Baa**<br>Obligations rated Baa are subject to moderate credit risk. They are considered medium-grade and as such may possess certain speculative characteristics. | **BBB**<br>An obligator rated 'BBB' has adequate capacity to meets its financial commitments. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligator to meet its financial commitments. |

## Arlingclose Economic & Interest Rate Forecast

| | Dec-12 | Mar-13 | Jun-13 | Sep-13 | Dec-13 | Mar-14 | Jun-14 | Sep-14 | Dec-14 | Mar-15 | Jun-15 | Sep-15 | Dec-15 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **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 |
| 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 | -0.25 |
| **3-month LIBID** | | | | | | | | | | | | | |
| Upside 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 |
| Central case | 0.75 | 0.75 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| Downside risk | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 |
| **1-yr LIBID** | | | | | | | | | | | | | |
| Upside risk | 0.25 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| Central case | 1.50 | 1.40 | 1.50 | 1.50 | 1.60 | 1.60 | 1.70 | 1.70 | 1.70 | 1.80 | 1.80 | 1.80 | 1.80 |
| 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 | 0.25 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| Central case | 0.60 | 0.60 | 0.70 | 0.70 | 0.70 | 0.80 | 0.80 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 |
| 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 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| Central case | 1.50 | 1.40 | 1.50 | 1.60 | 1.60 | 1.70 | 1.70 | 1.80 | 1.80 | 1.80 | 1.90 | 1.90 | 1.90 |
| 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 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| Central case | 2.50 | 2.40 | 2.40 | 2.40 | 2.50 | 2.50 | 2.60 | 2.50 | 2.50 | 2.60 | 2.60 | 2.60 | 2.60 |
| Downside risk | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 |
| **50-yr gilt** | | | | | | | | | | | | | |
| Upside risk | 0.25 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| Central case | 3.00 | 2.90 | 2.90 | 3.00 | 3.10 | 3.10 | 3.20 | 3.20 | 3.20 | 3.20 | 3.20 | 3.30 | 3.30 |
| Downside risk | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 |

**Underlying Assumptions:**

- Consumer Price Inflation (CPI) has fallen to 2.7 per cent from a peak of 5.2 per cent. Near term CPI is likely to be affected by volatility in commodity process and its decrease towards the two per cent target is expected to be slower than previously estimated.
- Strong quarter three growth data has provided encouragement with the larger than expected one per cent rise in GDP. Consumers are yet to loosen purse strings and businesses are still reticent to make long term investments. The momentum in growth is unlikely to be sustained whilst uncertainty over the economic outlook persists.
- In the absence of large, unexpected decline in growth, QE is likely to remain on hold at £375 billion 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 per cent unemployment, inflation one to two years out projected to remain below 2.5 per cent, longer term inflation expectations remain well anchored) is likely to increase market uncertainty around the highly volatile US employment data releases.
- The US ‘fiscal cliff’ still remains unresolved and is a growing worry as 31 December nears; there is expected to be a last minute compromise between Congress and the White House to avert automatic tax rises and spending cuts.
- The Eurozone is making slow headway (the European Stability Mechanism is now operational, announcements on the OMT programme, slow progress towards banking union) which has placated markets and curtailed some of the immediate risks although peripheral countries continue to struggle. Full-fledged banking and fiscal union is still some years away.