CHESHIRE EAST COUNCIL

REPORT TO: CABINET

Date of Meeting:	14 February 2011
Report of:	Borough Treasurer and Head of Assets
Subject/Title:	Treasury Management Strategy and MRP Statement 2011/12
Portfolio Holder:	Councillor Wesley Fitzgerald

1.0 Report Summary

1.1 To present the Treasury Management Strategy for 2011/12 to 2013/14 including the prudential indicators and limits required under Part 1of the Local Government Act 2003 and the Annual Investment Strategy 2010/11 and Annual Policy Statement on Minimum Revenue Provision (MRP) for the redemption of debt 2011/12.

1.2 Treasury Management is defined as:-

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

2.0 Decision Requested

2.1 Cabinet is requested to recommend to Council the approval of the Treasury Management Strategy and the MRP Statement for 2011/12. The Strategy includes the Department for Communities and Local Government (DCLG) reporting requirements in accordance with the Local Government Investments Guidance under Section 15(1)(a) of the Local Government Act 2003 (Appendix A).

3.0 Reasons for Recommendations

3.1 The Treasury Management Strategy details the activities of the Treasury Management function in the forthcoming year 2011/12. The Strategy for 2011/12 reflects the views on interest rates of leading market forecasts provided by Arlingclose, the Council's advisor on treasury matters. It also includes the Prudential Indicators relating to Treasury Management.

3.2 The CIPFA Code of Practice on Treasury Management, when adopted by a local authority, gives it the status of 'a code of practice made or approved by or under enactment' and hence proper practices under the provision of the Local Government and Housing Act 1989.

4 Wards Affected

4.1 Not applicable

5.0 Local Ward Members

5.1 Not applicable

6.0 Policy Implications including – Carbon Reduction
- Health

6.1 Not applicable.

7.0 Financial Implications (Authorised by the Borough Treasurer)

7.1 Effective Treasury Management provides support towards the achievement of service priorities, it allows the Council to invest in capital projects without any limit as long as it can demonstrate that its capital expenditure plans are affordable, external borrowing is prudent and sustainable and treasury decisions are taken in accordance with good practice.

8.0 Legal Implications (Authorised by the Borough Solicitor)

8.1 It is a requirement of the CIPFA Code of Practice for Treasury Management in The Public Sector, that Council receives an Annual Report on its Treasury Strategy, that Council sets Prudential Indicators for the next three years and approves an Annual Investment Strategy and an Annual MRP Policy Statement. There are stringent legislative requirements in place which dictate the way that a local authority deals with financial administration.

9.0 Risk Management

9.1 The steps outlined in this report will significantly mitigate the main legal and financial risk to the council's financial management:

a. That council borrowing will comply with the Treasury Management Strategy

10.0 Background and Options

10.1 The Local Government and Public Involvement in Health Act 2007 places a requirement of all councils to approve a policy on how the amount provided in respect of the repayment of debt is calculated prior to the start of the financial year concerned. The Policy for the year 2011/12 is contained in Appendix A. It links closely with the Council's Capital Strategy 2011/12, which sets out the approach to capital investment and disposals over the next three years.

10.2 The Treasury Management Strategy takes into account future borrowing requirements, based on the Council's three year capital spending plans, projected cash flow requirements and money market opportunities. The aim is to maintain control over borrowing activities, with particular regard for longer term affordability; but also to allow sufficient flexibility to respond to changes in the capital and money markets as they arise. The budgeted provision for the repayment of debt in the year 2011/12 has been broadly calculated as 4% of the estimated outstanding debt at the end of the year 2010/11 with a small number of exceptions. This is based on the assumption that debt will generally be repaid over 25 years. Exceptionally, where assets are to be funded from unsupported borrowing, debt repayments are profiled over the estimated life of the specific asset in question.

10.3 The amount provided for debt repayment is below the amount of capital expenditure being funded from borrowing in each of the next few years. As a consequence the amount of debt outstanding is increasing each year. As the level of outstanding debt increases the amount that needs to be provided for the repayment of debt in future years also increases. In order to reduce the amount of increasing debt year on year the Council may either use capital receipts as an alternative to borrowing or repay the debt more quickly.

10.4 The forecast for future capital receipts has remained at a prudent level for 2011-12 and therefore receipts of £5m will be made available to fund new schemes within the 2011/12 programme. The Council has implemented a Disposals Policy as part of the Asset Management Plan, where property assets which are not meeting the Council's objectives will be subject to asset challenge and a process of rationalisation and disposal for surplus/under-performing property will be adopted. The Council's Capital Receipts Policy will ensure that receipts are used in the most beneficial way to support corporate priorities and strategic objectives of the Council and all receipts will be pooled centrally.

10.5 The announcement of specific capital grants in December 2010 revealed a significant reduction in available funding for the 2011-12 capital programme; this has particularly affected schools, highways and housing strategy. As well as a reduction in capital grants the government is no longer providing any new Supported Borrowing allocations in 2011/12 and 2012/13.

10.6 Given the reductions in available funding the Council has undertaken prudential borrowing to fund £16m of new starts in 2011-12. The Council is conscious of the impact of repayment costs on the revenue budget and has only considered schemes where capital investment is required to secure long term revenue savings and repayment costs are affordable.

10.7 The Council has received a capitalisation direction from the Secretary of State enabling up to £675,329 of statutory redundancy payments to be treated as capital expenditure. This will provide flexibility for wider capitalisation opportunities beyond the funding of the capital programme.

10.8 **Capital Financing Budget 2011-12**

	£m
Repayment of outstanding debt	9.4
Interest on long term loans	6.1
Contribution from services towards the cost of borrowing	(0.8)
Total Debt Repayment	**14.7**
Less Interest receivable on cash balances	(0.8)
Net Capital Financing Budget	**13.9**

10.9 The amount of interest paid on the Council's portfolio of long term loans is mainly at fixed rates of interest (circa 4.9%). This provides a degree of certainty to the capital financing budget. The rate of interest payable on the £24 million of new long term loans that it is planned to raise during the year 2011/12 is budgeted to be 5.4%. Currently long term interest rates are around 5.4%. However, within the Treasury Management Strategy, the Council will use internal balances where possible to reduce the costs in the short term of external borrowing.

10.10 The Council currently has debt outstanding of £135.5m. In 2010/11 the opportunity was taken to restructure £50m of debt by replacing a number of loans with an average interest rate of 4.22% with a new loan at a rate of 2.35%. This will generate savings over the next ten years of £4.47m of which £0.6m will be achieved in 2010/2011 and £0.8m in 2011/2012.

10.11 The rate of interest to be earned on the Council's cash balances that are temporarily invested pending their being used (estimated at £70 million) is budgeted to be 1.15%.

10.12 Cheshire East inherited investments made by the former Cheshire County Council with Heritable Bank, which went into administration in October 2008. Any expected losses associated with this were accounted for by Cheshire County Council in their accounts in 2008/2009. As at 31st March 2010 the balance sheet included investments with Heritable Bank of £2.13m of which £0.7m is expected to be repaid to Cheshire East BC by 31st March 2011. The remainder is expected to be received in instalments ending in September 2012.

11.0 *Access to Information*

The background papers relating to this report can be inspected by contacting the report writer:

Name: Lisa Quinn
Designation: Borough Treasurer and Head of Assets
Tel No: 01270 686628
Email: lisa.quinn@cheshireeast.gov.uk

Appendices:

Appendix A – Treasury Management Strategy Statement & Investment Strategy 2011/12-2013/14

APPENDIX A

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

Contents

1. **Background**

2. **Balance Sheet and Treasury Position**

3. **Outlook for Interest Rates**

4. **Borrowing and Rescheduling Strategy**

5. **Investment Policy and Strategy**

6. **Balanced Budget Requirement**

7. **2011/12 MRP Statement**

8. **Reporting on the Treasury Outturn**

9. **Other Items**

Appendices

A. Prudential Indicators

B. Interest Rate Outlook

C. Specified Investments for use by the Council

D. Non- Specified Investments for use by the Council

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 on an annual basis. The TMSS also incorporates the Investment Strategy as required under the CLG's Investment Guidance.

1.2 CIPFA has defined Treasury Management as:
"the management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

1.3 The Council is responsible for its treasury decisions and activity. No treasury management activity is without risk. The successful identification, monitoring and control of risk is an important and integral element of its treasury management activities. The main risks to the Council's treasury activities are:

- Liquidity Risk (Inadequate cash resources)
- Market or Interest Rate Risk (Fluctuations in interest rate levels)
- Inflation Risk (Exposure to inflation)
- Credit and Counterparty Risk (Security of Investments)
- Refinancing Risk (Impact of debt maturing in future years)
- Legal & Regulatory Risk

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

1.5 The purpose of this Treasury Management Strategy Statement is to approve:

- Treasury Management Strategy for 2011-12 (Borrowing - Section 4, Debt Rescheduling - Section 5, Investments - Section 6)
- Prudential Indicators – Annex A (NB - PI No. 6 - The Authorised Limit is a statutory limit)
- Use of Specified and Non-Specified Investments – Annexes C & D

2. Balance Sheet and Treasury Position

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

	31/03/2011 Estimate £m	31/03/2012 Estimate £m	31/03/2013 Estimate £m	31/03/2014 Estimate £m
Capital Financing Requirement	206.4	220.7	217.4	211.6
Less: Existing Profile of Borrowing and Other Long Term Liabilities	-155.1	-149.6	-144.1	-138.6
Cumulative Maximum External Borrowing Requirement	51.3	71.1	73.3	73.0
Balances & Reserves	-36.7	-36.2	-37.0	-36.4
Cumulative Net Borrowing Requirement/ (Investments)	**14.6**	**34.9**	**36.3**	**36.6**

2.2 The Council's level of physical debt and investments is linked to these components of the Balance Sheet. Market conditions, interest rate expectations and credit risk considerations will influence the Council's strategy in determining the borrowing and investment activity against the underlying Balance Sheet position.

2.3 As the CFR represents the level of borrowing for capital purposes and revenue expenditure cannot be financed from borrowing, net physical external borrowing should not exceed the CFR other than for short term cash flow requirements. It is permissible under the Prudential Code to borrow in advance of need up to the level of the estimated CFR over the term of the Prudential Indicators. Where this takes place the cash will form part of its invested sums until the related capital expenditure is incurred. This being the case net borrowing should not exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years other than in the short term due to cash flow requirements.

2.4 The projected analysis of actual borrowings and investments as at 31st March 2011 is:

	31 Mar 11 Estimate £m	%
External Borrowing:		
Fixed Rate – PWLB	(115.4)	75
Fixed Rate – Market	(17.0)	11
Variable Rate – PWLB	-	-
Variable Rate – Market	-	-
Total External Borrowing	(132.4)	86
IFRS Long Term Liabilities:		
- PFI	(21.2)	14
- Operating Leases	-	-
Total Gross External Debt	**(153.6)**	**100**
Investments:		

Managed in-house - Short-term monies (Deposits/ monies on call /MMFs) - Long-term investments *(maturities over 12 months)* *Managed externally* - By Fund Managers - Pooled Funds *(Investec)*	 53.0 - - 20.0	 73 - - 27
Total Investments	**73.0**	**100**
(Net Borrowing Position)/ Net Investment position	**80.6**	-

2.5 The estimate for interest payments in 2011/12 is £6.1m and for interest receipts is £0.8m.

3. Outlook for Interest Rates

3.1 The economic interest rate outlook provided by the Council's treasury advisor, Arlingclose Ltd, is attached at Annex B. The Council will reappraise its strategy from time to time and, if needs be, realign it with evolving market conditions and expectations for future interest rates.

4. Borrowing and Rescheduling Strategy

4.1 The Council's underlying need to borrow for capital purposes is measured by reference to its Capital Financing Requirement (CFR) – see Annex A. The CFR represents the cumulative capital expenditure of the local authority that has not been financed. To ensure that this expenditure will ultimately be financed, local authorities are required to make a Minimum Revenue Provision for Debt Redemption (MRP) from within the Revenue budget each year.

4.2 Capital expenditure not financed from internal resources (i.e. Capital Receipts, Capital Grants and Contributions, Revenue or Reserves) will produce an increase in the CFR (the underlying need to borrow) and in turn produce an increased requirement to charge MRP in the Revenue Account.

4.3 Physical external borrowing may be greater or less than the CFR, but in accordance with the Prudential Code, the Council will ensure that net external borrowing does not, except in the short term, exceed the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years.

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

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

4.5 Notwithstanding the issuance of Circular 147 on 20th October 2010 following the CSR announcement which increases the cost of new local authority fixed rate loans to 1% above the cost of the Government's borrowing, the PWLB remains an attractive source of borrowing, given the transparency and control that its facilities continue to provide. The types of PWLB borrowing that are considered appropriate for a low interest rate environment are:

- Variable rate borrowing

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

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

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

4.8 The Council has three loans totalling £17m which are LOBO loans (Lender's Options Borrower's Option) of which two loans totalling £12m are currently in their call period. In the event that the lender exercises the option to change the rate or terms of these loans, the Council will consider the terms being provided and also repayment of the loans without penalty. The Council may utilise cash resources for repayment or may consider replacing the loans by borrowing from the PWLB.

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

- Savings in interest costs with minimal risk
- Balancing the volatility profile (i.e. the ratio of fixed to variable rate debt) of the debt portfolio
- Amending the profile of maturing debt to reduce any inherent refinancing risks.

As opportunities arise, they will be identified by Arlingclose and discussed with the Council's officers.

5. Investment Policy and Strategy

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

5.2 To comply with the CLG's guidance, the Council's general policy objective is to invest its surplus funds prudently. The Council's investment priorities are:

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

5.3 Investments are categorised as 'Specified' or 'Non Specified' investments based on the criteria in the CLG Guidance. Potential instruments for the Council's use within its investment strategy are contained in Annexes C and D. The Borough Treasurer and Head of Assets under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators.

5.4 Changes to investment strategy for 2011/12 include:

- AAA-rated Variable Net Asset Value (VNAV) Money Market Funds
- T-Bills

- Local Authority Bills
- Term deposits in Sweden
- Maximum duration for new deposits 2 years

Investments managed in-house

5.5 The Council's shorter term cash flow investments are made with reference to the outlook for the UK Bank Rate and money market rates.

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

5.7 The Council selects countries and the institutions within them (see Annex C) for the counterparty list after analysis and careful monitoring of:

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

5.8 The Council and its Treasury Advisors, Arlingclose, will continue to analyse and monitor these indicators and credit developments on a regular basis and respond as necessary to ensure security of the capital sums invested.

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

5.10 To protect against a lower for longer prolonged period of low interest rates and to provide certainty of income, 1 to 2-year deposits and longer-term secure investments will be actively considered within the limits the Council has set for Non-Specified Investments (see Annex D) and in accordance with the Prudential Indicator for sums invested over 364 days (see Annex A). The longer-term investments will be likely to include:

- Term Deposits with counterparties rated at least A+ (or equivalent)
- Supranational Bonds (bonds issued by multilateral development banks): Even at the lower yields likely to be in force, the return on these bonds will provide certainty of income against an outlook of low official interest rates.

Investments managed externally

<u>Funds managed on a segregated basis</u>

5.11 The Council's funds are also managed on a discretionary basis by Investec. The fund's remit allows the managers scope to add value through the use of investments contained in Annex D and within the parameters and guidelines set for the Council's fund. Performance is monitored and measured against the benchmark set for the fund, prevailing economic conditions and investment opportunities. External investment managers are contractually required to comply with the Investment Strategy.

5.12 The fund manager's expectation on the range of returns is based on their economic outlook and their forecasts for gilt/bond yields and money market rates. This fund is no longer deemed suitable for the low interest environment and all funds are being recalled with the fund likely to be wound up on 31st March 2011.

Collective Investment Schemes (Pooled Funds):

5.13 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.

5.14 Investments in pooled funds will be undertaken with advice from Arlingclose. The Council is planning to invest in a Pooled Fund with Investec who are currently demonstrating good performance. The performance and continued suitability of these funds in meeting the Council's investment objectives are regularly monitored.

6. Balanced Budget Requirement

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

7. 2011/12 MRP Statement

7.1 The Local Authorities (Capital Finance and Accounting)(England)(Amendment) Regulations 2008 (SI 2008/414) place a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Secretary of State and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

7.2 The four MRP options available are:

Option 1: Regulatory Method

MRP is equal to the amount determined in accordance with the 2003 Regulations (as amended), as if they had not been revoked by the 2008 Regulations

Option 2: CFR Method

MRP is equal to 4% of the Capital Financing Requirement (CFR), as derived from the balance sheet at the end of the preceding financial year

Option 3: Asset Life Method

MRP is determined by reference to the life of the asset, by equal instalment method or annuity method

Option 4: Depreciation Method

MRP is to be equal to the provision required in accordance with depreciation accounting

NB This does not preclude other prudent methods.

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

7.4 The MRP Statement will be submitted to Council before the start of the 2011/12 financial year. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement should be put to Council at that time.

7.5 The Council will apply Option 2 in respect of supported capital expenditure and Option 3 in respect of unsupported capital expenditure.

8. Reporting on the Treasury Outturn

8.1 The Borough Treasurer & Head of Assets will report to the Cabinet on treasury management activity / performance as follows:
(a) Quarterly against the strategy approved for the year.
(b) The Council will produce an outturn report on its treasury activity no later than 30th September after the financial year end.
(c) The Cabinet will be responsible for the oversight of performance on treasury management activity and practices.

8.2 An update on Treasury Management Investments and key activity will be reported to Corporate Management Team and Cabinet members on a weekly basis.

9. <u>Other items</u>

Training

9.1 CIPFA's Code of Practice requires the Borough Treasurer & Head of Assets 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.

9.2 Treasury management staff will have regular access to training opportunities to ensure they are fully up to date with developments. This will be delivered by a combination of workshops provided by Arlingclose and CIPFA technical updates.

9.3 Treasury management training for those members charged with governance will also be arranged during the 2011/12 financial year.

Investment Consultants

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

- Whether and, if so, how the authority uses external contractors offering information, advice or assistance relating to investment and

- How the quality of any such service is controlled.

9.5 Cheshire East BC has appointed Arlingclose Ltd to advise on investments following a joint tender exercise carried out with Cheshire West and Chester Council. The Council expects to be kept regularly informed on any changes in opinion on potential counterparties with immediate notification of potential problems with any counterparties. A regular review is carried out by Arlingclose on all aspects of Cheshire East's investment activities.

ANNEX A

PRUDENTIAL INDICATORS 2011/12 TO 2013/14

1 Background:

1.1 There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators.

2. Net Borrowing and the Capital Financing Requirement:

2.1 This is a key indicator of prudence. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that the net external borrowing does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

2.2 The Borough Treasurer & Head of Assets reports that the authority had no difficulty meeting this requirement in 2010/11, 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.

No. 1	Capital Expenditure	2010/11 Approved £m	2010/11 Revised £m	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m
	Total	**103**	**90**	**77**	**27**	**22**

3.2 Capital expenditure will be financed as follows:

Capital Financing	2010/11 Approved £m	2010/11 Revised £m	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m
Capital receipts	24	21	16	3	1
Government grants	52	40	35	15	15
External contributions	1	5	1	0	0
Revenue contributions	4	2	1	0	0
Supported borrowing	16	17	4	1	0
Unsupported borrowing	6	5	20	8	6
Total	**103**	**90**	**77**	**27**	**22**

Note: the element to be financed from borrowing impacts on the movement in the Capital Financing Requirement.

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 borrowing costs. The definition of financing costs is set out at paragraph 37 of the Prudential Code.

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

No. 2	Ratio of Financing Costs to Net Revenue Stream	2010/11 Approved	2010/11 Revised	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate
	Total	**5.64**	**4.91**	**5.59**	**6.11**	**6.28**

5. Capital Financing Requirement:

5.1 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and its financing. It is an aggregation of the amounts shown for Fixed and Intangible assets, the Revaluation Reserve, the Capital Adjustment Account, Government Grants Deferred and any other balances treated as capital expenditure**.

No. 3	Capital Financing Requirement	2010/11 Approved £m	2010/11 Revised £m	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m	*
	Total CFR	**184**	**206**	**221**	**217**	**212**	

** in line with CIPFA's guidance, any investments or other items not falling within the classification of fixed or intangible assets, but financed from capital resources must be included within the CFR for the purposes of this calculation.*

6. Actual External Debt:

6.1 This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

No. 4	Actual External Debt as at 31/03/2010	£m
	Borrowing	135
	Other Long-term Liabilities	23
	Total	**157**

7. Incremental Impact of Capital Investment Decisions:

7.1 This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax 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.

No. 5	Incremental Impact of Capital Investment Decisions	2010/11 Approved £	2011/12 Estimate £	2012/13 Estimate £	2013/14 Estimate £
	Increase in Band D Council Tax	3.27	2.33	8.77	2.83

8. Authorised Limit and Operational Boundary for External Debt:

8.1 The Council has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy and practice. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Council and not just those arising from capital spending reflected in the CFR.

8.2 The **Authorised Limit** sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) and is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

No. 6	Authorised Limit for External Debt	2010/11 Approved £m	2010/11 Revised £m	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m
	Borrowing	195	197	213	208	204
	Other Long-term Liabilities		23	22	22	21
	Total	**195**	**220**	**235**	**230**	**225**

8.3 The **Operational Boundary** links directly to the Council's estimates of the CFR and estimates of other cashflow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

8.4 The Borough Treasurer & head of Assets has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the next meeting of the Council.

No. 7	Operational Boundary for External Debt	2010/11 Approved £m	2010/11 Revised £m	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m
	Borrowing	185	187	203	198	194
	Other Long-term Liabilities		23	22	22	21
	Total	**185**	**210**	**225**	**220**	**215**

9. Adoption of the CIPFA Treasury Management Code:

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

No. 8	Adoption of the CIPFA Code of Practice in Treasury Management
	The Council approved the adoption of the CIPFA Treasury Management Code at its Council meeting on 25 February 2010

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

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

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

10.2 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

		2010/11 Approved %	2010/11 Revised %	2011/12 Estimate %	2012/13 Estimate %	2013/14 Estimate %
No. 9	**Upper Limit for Fixed Interest Rate Exposure**	100	100	100	100	100
No. 10	**Upper Limit for Variable Interest Rate Exposure**	100	100	100	100	100

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

11. Maturity Structure of Fixed Rate borrowing:

11.1 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.

11.2 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.

No. 11	**Maturity structure of fixed rate borrowing**	**Existing level as at 11/01/11 %**	**Lower Limit %**	**Upper Limit %**
	under 12 months	2%	0	25%
	12 months and within 24 months	4%	0	25%
	24 months and within 5 years	15%	0	35%
	5 years and within 10 years	20%	0	50%
	10 years and within 20 years	7%	0	100%
	20 years and within 30 years	14%	0	100%
	30 years and within 40 years	15%	0	100%
	40 years and within 50 years	23%	0	100%
	50 years and above	0%	0	100%

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.

No. 12	**Upper Limit for total principal sums invested over 364 days**	**2010/11 Approved %**	**2010/11 Revised %**	**2011/12 Estimate %**	**2012/13 Estimate %**	**2013/14 Estimate %**
		40	40	40	40	40

.

ANNEX B

Arlingclose's Economic and Interest Rate Forecast

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

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

Underlying assumptions:

- The framework and targets announced in the CSR to reduce the budget deficit and government debt are as announced in June and focuses on how the cuts are to be distributed. The next fiscal milestone will be the Office Of Budget Responsibility's assessment of the CSR's implications for growth, employment and inflation.
- The minutes of the Monetary Policy Committee's December meeting suggested a movement away from further Quantitative Easing. Despite Money Supply being weak and growth prospects remaining subdued the MPC have gravitated towards increasing rates in the new year as global inflation continues to rise along with household inflation.
- Consumer Price Inflation is stubbornly above 3% and is likely to spike above 4% in January as VAT, Utilities and Rail Fares are increased.
- Unemployment remains near a 16 year high, at just over 2.5 Million, and is set to increase as the Public Sector shrinks. Meanwhile employment is growing but this is mainly due to part time work, leaving many with reduced income.
- Recently announced Basel III capital/liquidity rules and extended timescales are positive for banks. Restructuring of UK banks' balance sheets is ongoing and expected to take a long time to complete. This will be a pre-condition for normalisation of credit conditions and bank lending.
- Mortgage repayment, a reduction in net consumer credit and weak consumer confidence are consistent with lower consumption and therefore future trend rates of growth, despite Q3's fairly strong performance.

- The US Federal Reserve downgraded its outlook for US growth; the Fed is concerned enough to signal further QE through asset purchases. Industrial production and growth in the Chinese economy are showing signs of slowing. Both have implications for the global economy.

Specified Investments

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

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

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

- Deposits in the DMO's Debt Management Account Deposit Facility
- Deposits with UK local authorities
- Deposits with banks and building societies
- *Certificates of deposit with banks and building societies
- *Gilts : (bonds issued by the UK government)
- *Bonds issued by multilateral development banks
- Treasury Bills (T-Bills)
- Local Authority Bills (LA Bills)
- AAA-rated Money Market Funds with a Constant Net Asset Value (CNAV)
- AAA-rated Money Market Funds with a Variable Net Asset Value (VNAV)
- Other Money Market Funds and Collective Investment Schemes– i.e. credit rated funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.

1. ** Investments in these instruments will be on advice from the Council's treasury advisor.*
2. *The use of the above instruments by the Council's fund manager(s) will be by reference to the fund guidelines contained in the agreement between the Council and the individual manager.*

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

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

In addition the Council will also make use of short term call accounts with the Councils current bankers, the Co-operative Bank, whose ratings are lower than the above minimum criteria.

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

New specified investments will be made within the following limits:

Instrument	Country	Counterparty	Maximum Limit of Investments %/£m
Term Deposits	UK	DMADF, DMO	No limit
Term Deposits/Call Accounts	UK	Other UK Local Authorities	No limit
Term Deposits/Call Accounts	UK	Bank of Scotland/Lloyds TSB	25% up to £20m
Term Deposits/Call Accounts	UK	Barclays	25% up to £20m
Term Deposits/Call Accounts	UK	Clydesdale (inc Yorkshire Bank)	25% up to £20m
Call Accounts	UK	Co-Operative Bank	25% up to £10m
Term Deposits/Call Accounts	UK	HSBC	25% up to £20m
Term Deposits/Call Accounts	UK	National Westminster Bank (note – part of RBS group)	25% up to £20m
Term Deposits/Call Accounts	UK	Nationwide Building Society	25% up to £20m
Term Deposits/Call Accounts	UK	Royal Bank of Scotland	25% up to £20m
Term Deposits/Call Accounts	UK	Santander (UK)	25% up to £20m
Term Deposits/Call Accounts	UK	Standard Chartered Bank	25% up to £20m
Term Deposits/Call Accounts	Australia	Australia and NZ Banking Group	15% up to £15m
Term Deposits/Call Accounts	Australia	Commonwealth Bank of Australia	15% up to £15m
Term Deposits/Call Accounts	Australia	National Australia Bank Ltd	15% up to £15m
Term Deposits/Call Accounts	Australia	Westpac Banking Corp	15% up to £15m
Term Deposits/Call Accounts	Canada	Bank of Montreal	15% up to £15m
Term Deposits/Call Accounts	Canada	Bank of Nova Scotia	15% up to £15m
Term Deposits/Call Accounts	Canada	Canadian Imperial Bank of Commerce	15% up to £15m
Term Deposits/Call Accounts	Canada	Royal Bank of Canada	15% up to £15m
Term Deposits/Call Accounts	Canada	Toronto-Dominion Bank	15% up to £15m
Term Deposits/Call Accounts	Finland	Nordea Bank Finland	15% up to £15m
Term Deposits/Call Accounts	France	BNP Paribas	15% up to £15m
Term Deposits/Call Accounts	France	Credit Agricole CIB	15% up to £15m
Term Deposits/Call Accounts	France	Credit Agricole SA	15% up to £15m

Term Deposits/Call Accounts	Germany	Deutsche Bank AG	15% up to £15m
Term Deposits/Call Accounts	Netherlands	ING Bank NV	15% up to £15m
Term Deposits/Call Accounts	Netherlands	Rabobank	15% up to £15m
Term Deposits/Call Accounts	Sweden	Svenska Handelsbanken	15% up to £15m
Term Deposits/Call Accounts	Switzerland	Credit Suisse	15% up to £15m
Term Deposits/Call Accounts	US	JP Morgan Chase Bank	15% up to £15m
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	EU	For Example: European Investment Bank/Council of Europe	25% up to £20m
AAA rated Money Market Funds	UK/Ireland/ Luxembourg	CNAV MMFs VNAV MMFs (where there is greater than 12 month history of a consistent £1 Net Asset Value)	25% up to £20m per fund Limit of 50% in all funds
Other MMFs and CIS	UK/Ireland/ Luxembourg	Pooled funds which meet the definition of a Collective Investment Scheme per SI 2004 No 534 and subsequent amendments	25% up to £20m

Note: If the credit rating of any of the above institutions falls below the minimum criteria then no further investments will be made with that institution until their credit ratings increase to at least the minimum criteria. Similarly if institutions whose credit ratings are currently below the minimum criteria and, therefore, not listed above have their credit ratings re-assessed so that they meet the minimum criteria then they may be considered suitable for investment (limits for UK institutions set at 25% up to £20m and non-UK institutions set at 15% up to £15m).

The above limits will also apply to banking groups where institutions are part of the same group (i.e where two or more named institutions are part of the same group of companies then the limit applies to the aggregate of investments with all institutions within the group).

A limit of 40% of total investments to apply to investments in non-UK banks at any one time with a limit of 25% of total investments in any one non-UK country.

Where practical any investments in Money Market Funds should be spread between at least two funds.

NB Any existing deposits outside of the current criteria will be reinvested with the above criteria on maturity.

Non-Specified Investments

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

	In-house use	Use by fund managers	Maximum maturity	Max % of portfolio	Capital expenditure?
▪ Deposits with banks and building societies ▪ Certificates of deposit with banks and building societies	✓ ✓	 ✓	5 yrs	25% in aggregate	No
Gilts and bonds ▪ Gilts ▪ Bonds issued by multilateral development banks ▪ Bonds issued by financial institutions guaranteed by the UK government ▪ Sterling denominated bonds by non-UK sovereign governments	✓ (on advice from treasury advisor)	✓	10 years	75% in aggregate	No
Money Market Funds and Collective Investment Schemes but which are not credit rated	✓ (on advice from treasury advisor)	✓	These funds do not have a defined maturity date	50%	No
Government guaranteed bonds and debt instruments issued by corporate bodies	✓	✓	10 years	25%	**Yes**
Non-guaranteed bonds and debt instruments issued by corporate bodies	✓	✓	10 years	25%	**Yes**
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	✓ (on advice from treasury advisor)	✓	These funds do not have a defined maturity date	50%	**Yes**

1. In determining the period to maturity of an investment, the investment should be regarded as commencing on the date of the commitment of the investment rather than the date on which funds are paid over to the counterparty.
2. The use of the above instruments by the Council's fund manager(s) will be by reference to the fund guidelines contained in the agreement between the Council and the individual manager.