CHESHIRE EAST COUNCIL

Cabinet

Date of Meeting:	4 February 2013
Report of:	Chief Executive/Director of Finance and Business Services
Subject/Title:	Treasury Management Strategy and MRP Statement 2013/14
Portfolio Holder:	Councillor Peter Raynes Portfolio Holder for Finance

1.0 Report Summary

1.1 To present the 2013/14 Treasury Management Strategy Statement (TMSS), incorporating the Minimum Revenue Provision (MRP) Policy Statement, Investment Strategy and Prudential and Treasury Indicators 2013/16, required under Part 1 of the Local Government Act 2003.

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.

1.3 The Council has carefully managed its Treasury Management function and this report shows how Cheshire East has continued to fund the capital programme without the need for external borrowing. No new long term loans have been take out during 2012/13 and the cash position remains strong with the Council likely to enter 2013/14 with increased cash balances.

2.0 Decision Requested

2.1 Cabinet is requested to recommend to Council the approval of the Treasury Management Strategy and the Minimum Revenue Provision Statement for 2013/14.

2.2 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.

3.0 Reasons for Recommendations

3.1 The Treasury Management Strategy details the activities of the Treasury Management function in the forthcoming year 2013/14. The Strategy for 2013/14 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 requires all local authorities to agree a Treasury Management Strategy Statement including an Investment Strategy annually in advance of the financial year. The strategy should incorporate the setting of the Council's prudential indicators for the three forthcoming financial years.

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 Director of Finance and Business Services)

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's Treasury Management in the Public Services: Code of Practice, 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 Treasury Management Strategy set out in Appendix A is also reported to the Audit & Governance Committee for scrutiny before being presented to Full Council for approval on 21st February 2013.

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.

10.3 A comprehensive review of the capital programme has been undertaken during 2012-13 with the intention of making substantial savings and focussing on initiatives with the highest priority. The key aims of the challenge to the existing programme has been to:

- Realign capital expenditure with corporate priorities;
- Cap the cost of financing the capital programme by reducing the need for future borrowing;
- Create financial & non-financial capacity to enable new schemes to come forward;
- Reassess business cases, particularly for investment projects.

10.4 In addition to the review of the capital programme, a balance sheet efficiency review has also been undertaken with the Council's treasury advisors, Arlingclose. This review aims to establish the most cost effective method of financing the capital programme and make adequate provision for the repayment of debt in future years. The review has considered the previous three financial years to form a view on the adequacy of the Council's reserves and working capital positions, as well as a projection of the expected position at the end of the following four financial years.

10.5 The methodology for applying capital receipts to finance capital expenditure has been considered as part of the review. An option available to the Council is to use capital receipts it currently holds in reserve and apply them to finance capital expenditure which has taken place in previous years and has been met from borrowing. This method is available to Council's wishing to use capital receipts to reduce debt repayment charges to revenue.

10.6 The application of the capital reserve will be undertaken in 2012-13 and will be used to repay £15m of borrowing for assets purchased after 2008 that are being written down over the various asset lives. The impact will be to reduce the level of revenue provision required for the repayment of debt in 2013-14 and future years by an estimated £2.4m.

10.7 In 2013-14 and future years, capital receipts in line with the Corporate Capital Receipts Policy will not be linked in any form to individual assets. Receipts will be fully applied to fund the capital programme in the year they are generated and the Council will hold no capital receipts in reserve on the balance sheet.

10.8 The savings in the short term on debt repayment charges will be off-set by increased debt repayment costs in future years as available capital receipts have been exhausted and future financing plans are realigned. New investment in the capital programme will need to be funded from borrowing to a greater extent in the future and therefore debt repayments may increase in the longer term.

10.9 The forecast for future capital receipts has remained at a prudent level for 2013-14 and therefore receipts of £10m will be made available to fund schemes within the 2013/14 programme.

10.10 The Council currently has external borrowing of £134m. The amount of interest paid on the Council's portfolio of long term loans is mainly at fixed rates of interest (circa 3.96%). This provides a degree of certainty to the capital financing budget. Currently long term interest rates are around 4.1%.

10.11 Within the Treasury Management Strategy, the Council will continue to minimise borrowing by making use of internal balances. This not only minimises costs, but also reduces the credit risk associated with investments, as the amount being invested is low. Given the current low interest rate environment is expected to continue throughout 2013/14 and beyond, the interest rate risk associated with delayed borrowing is assessed to be low.

10.12 The budgeted provision for the repayment of debt in the year 2013/14 has been broadly calculated as 4% of the estimated outstanding debt at the end of the year 2012/13. This is based on the assumption that debt will generally be repaid over 25 years. Where assets are to be funded from prudential borrowing, debt repayments are profiled over the estimated life of the specific asset in question.

10.13 The Council has undertaken prudential borrowing to fund £13m of new starts in 2013-14. 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.

10.14 The rate of interest to be earned on the Council's cash balances that are temporarily invested pending their being used (estimated at £66 million) is budgeted to be 0.5%.

Capital Financing Budget 2013-14

Capital Financing Budget	2012/13 Original £m	2012/13 Revised £m	2013/14 £m
Repayment of Outstanding Debt	9.5	9.2	6.9
Contribution re: Schools TLC Schemes	-0.8	-0.8	-0.9
Direct Revenue Funding	0.0	0.5	0.4
Interest on Long Term Loans	6.4	5.3	5.7
Total Debt Repayment	15.1	14.2	12.1
Less: Interest Receivable on Cash Balances	-0.3	-0.3	-0.2
Net Capital Financing Budget	14.8	13.9	11.9

10.15 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 2012 the balance sheet included investments with Heritable Bank of £0.8m of which £0.3m has since been repaid to Cheshire East BC. The remainder is expected to be received in instalments ending in April 2013 although this may be delayed due to ongoing litigation. The accounts currently provide for recovery of 88% of the original investments.

10.16 The principal changes to the 2013/14 Treasury Strategy have been:

- The addition to the lending list of further Non-UK banks although these are kept under continual review and can be deleted or added to as credit conditions change. In addition to credit ratings, the Council will also assess other indicators, such as credit default swaps, share prices, the sovereign's economic fundamentals, corporate developments highlighted through news articles and market sentiment. If any of these indicators give rise to concern, the counterparty may be suspended from further use irrespective of the existing credit rating.

  The revision to the credit criteria, once approved by Council for use in 2013/14, will also apply to the residual period of 2012/13.

- The addition to the lending list of Registered Providers. Typically these are Registered Social Landlords managing large quantities of housing stock.

- Following changes to CIPFA's guidance, the prudential indicator for net debt and capital financing requirement has been replaced with gross debt and the capital financing requirement. This has also resulted in the removal of the indicator 'Gross and Net Debt'.

11.0 *Access to Information*

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

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Appendices:

Appendix A – Treasury Management Strategy Statement & Investment Strategy 2013/14 – 2015/16

APPENDIX A

Treasury Management Strategy Statement and Investment Strategy 2013/14 to 2015/16

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<u>Annexes</u>

1. Background

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

1.2. As per the requirements of the Prudential Code, the Authority has adopted the CIPFA Treasury Management Code at a meeting of its Council on 23rd February 2012.

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

- revisions to Treasury Management Strategy and Prudential Indicators for 2012/13
- Treasury Management Strategy for 2013/14
- Annual Investment Strategy for 2013/14
- Prudential Indicators for 2013/14, 2014/15 and 2015/16 (Annex B)
- MRP Statement (Annex F)

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

2. Capital Financing Requirement

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

2.2 The Authority's currently has £159m of debt and £99m of investments. This is set out in further detail at ***Annex A***.

2.3 **Money Borrowed in Advance of Spending Need:** The Authority is able to borrow funds in excess of the current level of its CFR up to the projected level in 2015/16. The Authority is likely to only borrow in advance of need if it felt the benefits of borrowing at interest rates now compared to where they are expected to be in the future, outweighs the current cost and risks associated with investing the proceeds until the borrowing was actually required.

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

Table 1: Balance Sheet Summary Analysis

	2012/13 Estimate £m	2013/14 Estimate £m	2014/15 Estimate £m	2015/16 Estimate £m
General Fund CFR	196	227	253	260
Less: Existing Profile of Borrowing	-124	-118	-107	-98
Less: Other Long Term Liabilities	-23	-22	-21	-20
Cumulative Maximum External Borrowing Requirement	**49**	**87**	**125**	**142**
Usable Reserves	-37	-38	-38	-43
Cumulative Net Borrowing Requirement/(Investments)	**12**	**49**	**87**	**99**

3. Interest Rate Forecast

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

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

4. Borrowing Strategy

4.1 Treasury management and borrowing strategies in particular continue to be influenced not only by the absolute level of borrowing rates but also the relationship between short and long term interest rates. This difference creates a "cost of carry" for any new longer term borrowing where the proceeds are temporarily held as investments because of the difference between what is paid on the borrowing and what is earned on the investment. The cost of carry is likely to be an issue until 2016 or beyond. As borrowing is often for longer dated periods (anything up to 50 years) the cost of carry needs to be considered against a backdrop of uncertainty and affordability constraints in the Authority's wider financial position.

4.2 As indicated in Table 1, the Authority has a gross and net borrowing requirement and will be required to borrow up to £49m in 2013/14. The Authority will adopt a flexible approach to this borrowing in consultation with its treasury management advisers, Arlingclose Ltd. The following issues will be considered prior to undertaking any external borrowing:

- Affordability;
- Maturity profile of existing debt;
- Interest rate and refinancing risk;

– Borrowing source.

5. Sources of Borrowing and Portfolio Implications

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

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

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

5.3 The Authority has £17m exposure to LOBO loans (Lender's Option Borrower's Option) of which the whole £17m can be "called" within 2013/14. A LOBO is called when the Lender exercises its right to amend the interest rate on the loan at which point the Borrower can accept the revised terms or reject them and repay the loan. LOBO loans present a potential refinancing risk to the Authority since the decision to call a LOBO is entirely at the lender's discretion.

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

5.4 Other sources of borrowing will also be considered where it is advantageous to do so (e.g reduced rate or interest free loans in connection with project funding such as Energy Efficiency Loans Scheme for Highways LED lights).

6. Debt Rescheduling

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

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

- Reduce investment balances and credit exposure via debt repayment
- Align long-term cash flow projections and debt levels

- Savings in risk adjusted interest costs
- Rebalancing the interest rate structure of the debt portfolio
- Changing the maturity profile of the debt portfolio

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

7. Annual Investment Strategy

7.1 In accordance with Investment Guidance issued by the CLG and best practice this Authority's primary objective in relation to the investment of public funds remains the security of capital. The liquidity or accessibility of the Authority's investments is secondary, followed by the yield earned on investments which is a tertiary consideration.

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

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

Specified investments are sterling denominated investments with a maximum maturity of one year. They also meet the "high credit quality" as determined by the Authority and are not deemed capital expenditure investments under Statute. Non specified investments are, effectively, everything else.

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

Table 2: Specified and Non-Specified Investments

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

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

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

7.6 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 Annex E, the Director of Finance will have discretion to make investments with counterparties that do not meet the specified criteria on advice from Arlingclose.

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

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

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

7.7 **Authority's Banker** – The Authority banks with Co-operative Bank. At the current time, it does not meet the Authority's minimum credit criteria. Despite the credit rating being below the Authority's minimum criteria, Co-operative Bank will continue to be used for short term liquidity requirements (overnight and instant access investments) and business continuity arrangements.

7.8 The Authority may also grant loans at market rates to businesses where it is considered necessary to achieve the policy objectives of the Authority or where it is a condition for receipt of funds. A current example is the Growing Places Scheme where £13m is currently held by the Authority. Approval for any such schemes and the criteria for agreeing these loans will be obtained from the appropriate committee and will not, therefore, fall within the scope of the Treasury Management Strategy.

8. Investment Strategy

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

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

8.3 Money market funds (MMFs) will be utilised but good treasury management practice prevails and whilst MMFs provide good diversification the Authority will also seek to mitigate operational risk by utilising at least two MMFs. The Authority will also restrict its exposure to MMFs with lower levels of funds under management and will not exceed 0.5% of the net asset value of the MMF. In the case of the CCLA Public Sector Deposit Fund the maximum amount invested will be the higher of £1m or 0.5% of the net asset value of the fund. In the case of Government MMFs, the Council will ensure exposure to each Fund does not exceed 2% of the net asset value of the Fund.

8.4 Collective Investment Schemes (Pooled Funds):

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

8.5 Investments in pooled funds will be undertaken with advice from Arlingclose Ltd. Since May 2011, the Authority currently has investments of £20m in Pooled Funds with Investec; their performance and continued suitability in meeting the Authority's investment objectives are regularly monitored. Performance in the first 12 months was not as good as expected being adversely affected by the European debt crisis. However, since then performance has improved and the fund has started producing higher returns than in house investments.

9. Policy on Use of Financial Derivatives

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

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

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

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

10. 2013/14 MRP Statement

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

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

11.1 The Director of Finance and Business Services will report to the Audit and Governance Committee on treasury management activity/performance and Performance Indicators as follows:

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

12. Other Items

12.1 Training

CIPFA's Code of Practice requires the *responsible officer* to ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

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.

Treasury management training for those members charged with governance was provided in 2012/13 and updates will also be arranged during the 2013/14 financial year.

12.2 Treasury Management Advisors

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

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

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

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

	02/01/13 Actual Portfolio £m	02/01/13 Average Rate %
External Borrowing:		
PWLB – Fixed Rate	117	3.89%
PWLB – Variable Rate	0	-
LOBO Loans	17	4.49%
Total External Borrowing	**134**	**3.96%**
Other Long Term Liabilities:		
PFI	22	-
Finance Leases	3	-
Total Gross External Debt	**159**	-
Investments:		
Managed in-house		
Short-term investments	79	0.67%
Long-term investments	0	-
Managed externally		
Fund Managers	0	-
Pooled Funds *(please list)*	20	1.03%
Total Investments	**99**	**0.74%**
Net Debt	**60**	**-**

Annex B

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

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

2. **Gross Debt and the Capital Financing Requirement:**
This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for a capital purpose, the local authority should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.
If in any of these years there is a reduction in the capital financing requirement, this reduction is ignored in estimating the cumulative increase in the capital financing requirement which is used for comparison with **gross** external debt.
The Director of Finance reports that the Authority had no difficulty meeting this requirement in 2012/13, nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

3. **Estimates of Capital Expenditure:**

3.1 This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax.

Capital Expenditure	2012/13 Approved £m	2012/13 Revised £m	2013/14 Estimate £m	2014/15 Estimate £m	2015/16 Estimate £m
Total	**83.9**	**57.0**	**112.0**	**83.1**	**28.9**

3.2 Capital expenditure will be financed or funded as follows:

Capital Financing	2012/13 Approved £m	2012/13 Revised £m	2013/14 Estimate £m	2014/15 Estimate £m	2015/16 Estimate £m
Capital receipts	14.3	10.0	10.0	5.0	0.0
Government Grants	36.1	31.2	41.3	22.1	2.6
Other Grants/ Contributions	0.2	2.0	22.7	20.7	8.4
Revenue contributions	0.6	0.5	0.1	0.0	0.0
Total Financing	**51.2**	**43.7**	**74.1**	**47.8**	**11.0**
Supported borrowing	1.8	1.6	0.0	0.0	0.0
Unsupported borrowing	30.9	11.7	37.9	35.3	17.9
Total Funding	**32.7**	**13.3**	**37.9**	**35.3**	**17.9**
Total Financing and Funding	**83.9**	**57.0**	**112.0**	**83.1**	**28.9**

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

4. Ratio of Financing Costs to Net Revenue Stream:

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

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

Ratio of Financing Costs to Net Revenue Stream	2012/13 Approved %	2012/13 Revised %	2013/14 Estimate %	2014/15 Estimate %	2015/16 Estimate %
Total	**6.01**	**5.64**	**4.58**	**5.35**	**6.23**

5. Capital Financing Requirement:

5.1 The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and financing.

Capital Financing Requirement	2012/13 Approved £m	2012/13 Revised £m	2013/14 Estimate £m	2014/15 Estimate £m	2015/16 Estimate £m
Total CFR	**233**	**196**	**227**	**253**	**260**

6. Actual External Debt:

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

Actual External Debt as at 31/03/2012	£m
Borrowing	134
Other Long-term Liabilities	25
Total	**159**

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.

Incremental Impact of Capital Investment Decisions	2012/13 Approved £	2013/14 Estimate £	2014/15 Estimate £	2015/16 Estimate £
Increase in Band D Council Tax	6.02	0.00	11.92	10.77

8. Authorised Limit and Operational Boundary for External Debt:

8.1 The Authority 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 Authority and not just those arising from capital spending reflected in the CFR.

8.2 The **Authorised Limit** sets the maximum level of external debt on a gross basis (i.e. excluding investments) for the Authority. It is measured on a daily basis against all external debt items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities). This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Authority's existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.

8.3 The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

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

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

	2012/13 **Approved £m**	**2012/13** **Revised £m**	**2013/14** **Estimate £m**	**2014/15** **Estimate £m**	**2015/16** **Estimate £m**
Authorised Limit for Borrowing	245	208	240	267	275
Authorised Limit for Other Long-term Liabilities	23	23	22	21	20
Authorised Limit for External Debt	**268**	**231**	**262**	**288**	**295**
Operational Boundary for Borrowing	235	198	230	257	265
Operational Boundary for Other Long-term Liabilities	23	23	22	21	20
Operational Boundary for External Debt	**258**	**221**	**252**	**278**	**285**

9. Adoption of the CIPFA Treasury Management Code:

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

Adoption of the CIPFA Code of Practice in Treasury Management
The Council approved the adoption of the CIPFA Treasury Management Code at its Council meeting on 23rd February 2012.

The Authority 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 Authority to manage the extent to which it is exposed to changes in interest rates. This Authority 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 Authority 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

	Existing level (or Benchmark level) at 02/01/13 %	2012/13 Approved %	2012/13 Revised %	2013/14 Estimate %	2014/15 Estimate %	2015/16 Estimate %
Upper Limit for Fixed Interest Rate Exposure	100%	100%	100%	100%	100%	100%
Upper Limit for Variable Interest Rate Exposure	0%	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 Authority'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.

11.3 LOBOs are classified as maturing on the next call date i.e. the earliest date that the lender can require repayment. As all LOBOs are can be called within 12 months the upper limit for borrowing maturing within 12 months has been increased from 25% to 35% to allow for the value of LOBOs and any potential short term borrowing that could be undertaken in 2013/14.

Maturity structure of fixed rate borrowing	Existing level as at 02/01/13 %	Lower Limit for 2013/14 %	Upper Limit for 2013/14 %
under 12 months	17%	0%	35%
12 months and within 24 months	8%	0%	25%
24 months and within 5 years	15%	0%	35%
5 years and within 10 years	15%	0%	50%
10 years and within 20 years	16%	0%	100%
20 years and within 30 years	9%	0%	100%
30 years and within 40 years	9%	0%	100%
40 years and within 50 years	11%	0%	100%
50 years and above	0%	0%	100%

12. Credit Risk:

12.1 The Authority considers security, liquidity and yield, in that order, when making investment decisions.

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

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

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

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

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

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

Upper Limit for total principal sums invested over 364 days	2012/13 Approved %	2012/13 Revised %	2013/14 Estimate %	2014/15 Estimate %	2015/16 Estimate %
	40%	40%	40%	40%	40%

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

	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Official Bank Rate													
Upside risk			0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk		-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
3-month LIBID													
Upside risk	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75
Central case	0.40	0.40	0.40	0.45	0.45	0.50	0.50	0.50	0.55	0.55	0.55	0.60	0.60
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
1-yr LIBID													
Upside risk	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75
Central case	0.90	0.90	0.95	0.95	1.00	1.00	1.00	1.00	1.10	1.10	1.10	1.10	1.10
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
5-yr gilt													
Upside risk	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00
Central case	0.80	0.90	0.90	0.90	1.00	1.00	1.00	1.00	1.10	1.10	1.10	1.20	1.20
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
10-yr gilt													
Upside risk	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.00	1.00
Central case	1.90	1.90	2.00	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.20	2.20	2.20
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
20-yr gilt													
Upside risk	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00
Central case	2.80	2.80	2.80	2.80	2.90	2.90	2.90	2.90	3.00	3.00	3.00	3.00	3.00
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
50-yr gilt													
Upside risk	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00
Central case	3.30	3.30	3.30	3.40	3.40	3.40	3.50	3.50	3.50	3.50	3.60	3.60	3.60
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25

Underlying Assumptions:

- Consumer Price Inflation has fallen to 2.7% from a peak of 5.2%. Near term CPI is likely to be affected by volatility in commodity prices and its decrease towards the 2% target is expected to be slower than previously estimated.
- Strong Q3 growth data has provided encouragement with the larger than expected 1% 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 £375bn for now. The availability of cheaper bank borrowing and subsequently for corporates through the Funding for Lending Scheme (FLS) is a supporting factor.
- The US Federal Reserve's shift in its rate guidance from a date-based indication to economic thresholds (6.5% unemployment, inflation 1 – 2 years out projected to remain below 2.5%, longer term inflation expectations remain well anchored) is likely to increase market uncertainty around the highly volatile US employment data releases.
- The US 'fiscal cliff' was avoided with a last-minute compromise between Congress and the White House averting automatic tax rises and spending cuts. However, the problem remains and has merely been delayed rather than resolved.
- 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.

Annex D – Current Recommended Sovereign and Counterparty List as at 17/12/2012 (Section 8)

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

Country/ Domicile	Counterparty	Maximum Counterparty Limit %/£m	Maximum Maturity Limit (term deposits and instruments without a secondary market)[1]	Maximum Maturity Limit (negotiable instrument)[2]
UK	Co-operative Bank (for banking & liquidity purposes only)	15% up to £15m	Overnight	N/A
UK	Santander UK Plc (Banco Santander Group)	15% up to £15m	2 years	5 years
UK	Bank of Scotland (Lloyds Banking Group)	15% up to £15m	2 years	5 years
UK	Lloyds TSB (Lloyds Banking Group)	15% up to £15m	2 years	5 years
UK	Barclays Bank Plc	15% up to £15m	2 years	5 years
UK	HSBC Bank Plc	15% up to £15m	2 years	5 years
UK	Nationwide Building Society	15% up to £15m	2 years	5 years
UK	NatWest (RBS Group)	15% up to £15m	2 years	5 years
UK	Royal Bank of Scotland (RBS Group)	15% up to £15m	2 years	5 years
UK	Standard Chartered Bank	15% up to £15m	2 years	5 years
Australia	Australia and NZ Banking Group	15% up to £15m	2 years	5 years
Australia	Commonwealth Bank of Australia	15% up to £15m	2 years	5 years
Australia	National Australia Bank Ltd (National Australia Bank Group)	15% up to £15m	2 years	5 years
Australia	Westpac Banking Corp	15% up to £15m	2 years	5 years
Canada	Bank of Montreal	15% up to £15m	2 years	5 years
Canada	Bank of Nova Scotia	15% up to £15m	2 years	5 years
Canada	Canadian Imperial Bank of Commerce	15% up to £15m	2 years	5 years
Canada	Royal Bank of Canada	15% up to £15m	2 years	5 years
Canada	Toronto-Dominion Bank	15% up to £15m	2 years	5 years
Finland	Nordea Bank Finland	15% up to £15m	2 years	5 years
Finland	Pohjola	15% up to £15m	2 years	5 years
France	BNP Paribas	15% up to £15m	2 years	5 years
France	Credit Agricole CIB (Credit	15% up to £15m	2 years	5 years

[1] *2 years is the maximum approved duration for term deposits and illiquid investments (those without a secondary market), although in practice the Authority may be investing on a shorter term basis depending on operational advice of the authority's treasury management adviser.*

[2] *5 years is the maximum approved duration for negotiable instruments such as Certificates of Deposits, Medium Term Notes and Corporate Bonds, although in practice the Authority may be investing for shorter periods depending on operational advice of the authority's treasury management adviser.*

	Agricole Group)			
France	Credit Agricole SA (Credit Agricole Group)	15% up to £15m	2 years	5 years
France	Société Générale	15% up to £15m	2 years	5 years
Germany	Deutsche Bank AG	15% up to £15m	2 years	5 years
Netherlands	ING Bank NV	15% up to £15m	2 years	5 years
Netherlands	Rabobank	15% up to £15m	2 years	5 years
Netherlands	Bank Nederlandse Gemeenten	15% up to £15m	2 years	5 years
Singapore	DBS Bank Ltd	15% up to £15m	2 years	5 years
Singapore	Oversea-Chinese Banking Corporation (OCBC)	15% up to £15m	2 years	5 years
Singapore	United Overseas Bank (UOB)	15% up to £15m	2 years	5 years
Sweden	Svenska Handelsbanken	15% up to £15m	2 years	5 years
Switzerland	Credit Suisse	15% up to £15m	2 years	5 years
US	JP Morgan	15% up to £15m	2 years	5 years
UK/Ireland/ Luxembourg	AAA rated Money Market Funds (CNAV and VNAV)	25% subject to fund size (see paragraph 8.3) Limit of 50% in all funds	Instant Access	N/A

Please note this list could change if, for example, a counterparty/country is upgraded, and meets our other creditworthiness tools or a new suitable counterparty comes into the market. Alternatively, if a counterparty is downgraded, this list may be shortened.

Group Limits - For institutions within a banking group, the authority applies the limit applicable to the individual limit of a single bank within that group.

Annex E – Non-Specified Investments

Instrument	Maximum maturity	Max % of portfolio	Capital expenditure?	Example
Term deposits with banks, building societies which meet the specified investment criteria (on advice from TM Adviser)	2 years	25%	No	
Term deposits with local authorities	5 years	No limit	No	
CDs and other negotiable instruments with banks and building societies which meet the specified investment criteria (on advice from TM Adviser)	5 years	25%	No	
Investments with banks and building societies which **do not meet** the specified investment criteria (on advice from TM Adviser and authority from S151 Officer)	3 months	25%	No	
Deposits with registered providers	5 years	25%	No	
Gilts	10 years	100%	No	
Bonds issued by multilateral development banks	10 years	50%	No	EIB Bonds, Council of Europe Bonds etc.
Sterling denominated bonds by non-UK sovereign governments	10 years	50%	No	
Money Market Funds and Collective Investment Schemes	These funds do not have a defined maturity date	50%	No	Investec Target Return Fund;
Corporate and debt instruments issued by corporate bodies purchased from 01/04/12 onwards	10 years	25%	No	
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 and subsequent amendments	These funds do not have a defined maturity date	50%	Yes	Way Charteris Gold Portfolio Fund; Aviva Lime Fund

Annex F – MRP Statement 2013/14

CLG's Guidance on Minimum Revenue Provision (issued in 2010) places a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Secretary of State and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

The four MRP options available are:

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

NB This does not preclude other prudent methods.

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

The MRP Statement will be submitted to Council before the start of the 2013/14 financial year. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement should be put to Authority at that time.

The Authority will apply **Option 2** in respect of supported Non-HRA capital expenditure funded from borrowing and **Option 3** respect of unsupported Non-HRA capital expenditure funded from borrowing.

And

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