OVERVIEW AND SCRUTINY **2 February 2012**
CABINET **16 February 2012**

2012/13 TREASURY MANAGEMENT STRATEGY
(Report by the Head of Financial Services)

1. PURPOSE

1.1 Annex A gives the requirements of the Council's Code of Financial Management in relation to Treasury Management. It requires compliance with CIPFA guidance and also that it reflects any Government advice. CIPFA have issued a revised version of their code and the Department for Communities and Local Government (DCLG) guidance expects priority to be given to the security (protecting any invested sums from loss) and liquidity of investments (keeping enough cash readily available) rather than just the interest earned.

1.2 When the Government removed its limits on capital expenditure levels some years ago it introduced the concept of a Prudential Code which focussed attention on relevant indicators to demonstrate that the Council's capital expenditure plans are affordable and effectively managed. These Prudential Indicators are an annex to the Treasury Management Strategy.

1.3 The proposed Policy (Annex B) and 2011/12 Strategy (Annex B) comply with the CIPFA and DCLG guidance.

1.4 The member Treasury Management Advisory Group have discussed the Policy and Strategy and their comments have been incorporated. Overview and Scrutiny will consider the report on the 2 February and their comments will be available to the Cabinet. Council is then required to formally approve the Policy, Strategy and Prudential Indicators.

2. RECOMMENDATION

2.1 Cabinet is requested to recommend to Council that it approves

a) The Treasury Management Policy in Annex B.
b) The Treasury Management and Prudential Indicators for 2012/13 in Annex C.

BACKGROUND PAPERS:

Background files in Accountancy Section: Treasury Management Reports

Reports on the 2012/13 Budget and Medium Term Plan to Cabinet and Council

CIPFA's Treasury Management in the Public Services Code of Practice 2011 edition

ODPM Guidance on Local Government Investments March 2004
CLG Guidance on Local Government Investments March 2010

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ANNEX A

Code of Financial Management (extract)

Treasury Management

All Treasury Management activities will be undertaken in accordance with the Council's annual Treasury Management Strategy, which includes its policies, objectives, approach to risk management and its prudential indicators. The Strategy will comply with the Code of Practice for Treasury Management and the Prudential Code for Capital Finance, both published by the Chartered Institute of Public Finance and Accountancy (CIPFA), and reflect any published Government advice..

The Council shall have overall responsibility for Treasury Management and will formally approve the annual Treasury Management Strategy and receive an annual and mid-year report on treasury management activities.

The Cabinet will be responsible for the implementation and regular monitoring of treasury management activity and the Treasury Management Advisory Group (previously CRAG), which consists of three Cabinet members will act as an informal liaison group with the officers responsible for treasury management.

The Overview and Scrutiny (Economic Well-being) Panel will be responsible for the scrutiny of treasury management.

The execution and administration of treasury management is delegated to the Head of Financial Services who will establish treasury management practices for the operation of the function which will ensure compliance with the Strategy and create appropriate systems of monitoring and control.

ANNEX B

TREASURY MANAGEMENT POLICY STATEMENT

Definition

The Council defines its treasury management activities as:

- the management of the Council's investments, cash flows, 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.

Risk management

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

Value for money

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

Borrowing policy

The Council needs to balance a number of elements in its borrowing policy for funding capital expenditure:

- Utilising a mixture of borrowing periods to reduce the overall impact of changes in interest rates.
- Creating certainty by fixing borrowing for longer periods.
- Minimising the long term cost of any borrowing.
- Ensuring that short term costs are as low as possible.
- Using the Council's own reserves on a temporary basis

Clearly some of these elements can give contradictory answers and the decision on each borrowing decision will need to be based on balancing these elements, taking account of existing borrowing.

The Council will set an affordable borrowing limit each year in compliance with the *Local Government Act 2003*, and will have regard to the *CIPFA Prudential Code for Capital Finance in Local Authorities* when setting that limit. It will also set limits on its exposure to changes in interest rates and limits on the maturity structure of its borrowing in the treasury management strategy report each year.

Investment policy

All investment decisions need to follow a risk assessment which takes account of the need to protect the principal sums invested from loss, ensuring adequate liquidity so that funds are available to fund expenditure when needed, and the generation of investment income to support the provision of local authority services. Adequate weighting must be given to data reflecting the security of the investment.

Governance

The Council will have regard to the Communities and Local Government Guidance on Local Government Investments and will approve an investment strategy each year as part of the treasury management strategy. The strategy will set criteria to determine suitable organisations with which cash may be invested, limits on the maximum duration of such investments and limits on the amount of cash that may be invested with any one organisation.

ANNEX C

TREASURY MANAGEMENT STRATEGY 2012/13

Treasury Management is:

- **Ensuring the Council has sufficient cash to meet its day-to-day obligations**
- **Borrowing when necessary to fund capital expenditure, including borrowing in anticipation when rates are considered to be low**
- **Investing any surplus funds in a manner that balances low risk of default by the borrower with a fair rate of interest.**

This Strategy explains how Treasury Management will be carried out in Huntingdonshire. It meets the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice (2011) and the Government's Guidance on Local Government Investments (2010)

BACKGROUND

The bank base rate fell to 0.5% in March 2009 and has remained at that level ever since. The UK economy is continuing its weak recovery from the 2008/09 recession, with GDP growth forecast to be around just 1.0% in 2011 and likely to remain sluggish throughout much of 2012. Government spending cuts, rising unemployment and uncertain export markets are conspiring to keep demand low, and a "double dip" recession cannot be ruled out. Consumer price inflation, which peaked at 5.2% in September 2011, is expected to fall sharply as one-off factors like 2010's VAT increase and fuel price rises fall out of the annual comparison.

In these circumstances, the Bank of England is unlikely to raise the bank rate for several months, and additional quantitative easing is seen by many as being more likely than rate increases in the near future. However, once a more robust recovery appears to be taking root, the Bank may prefer to gradually raise interest rates earlier, rather than waiting too late and needing to make a sharp correction.

The Eurozone sovereign debt crisis remains a major driver of market sentiment and with the UK seen a safe haven, gilt yields and hence PWLB rates have fallen markedly this year. Assuming that there is some resolution to the crisis, long-term rates are likely to climb back to more normal levels in 2012/13.

A second UK recession or a European sovereign default would see short and long term interest rates remaining lower for longer, while a faster economic recovery and a bold solution to the Eurozone crisis would likely see rates rise more quickly.

For the purpose of the Council's Medium Term Plan the following interest rates have been assumed but it is recognised that all assumptions about the speed with which rates will begin to rise is problematic.

	2012/13	2013/14	2014/15	2015/16	2016/17
	%	%	%	%	%
Temporary investments	1.10	1.90	2.00	2.50	2.50
PWLB 40 year borrowing (EOY)	4.65	4.85	5.10	5.30	5.50
Temporary borrowing	0.85	1.50	1.75	2.25	2.50

Against the background of low interest rates and reducing revenue and capital balances the Council has sought to maximise the returns from its investments whilst minimising the risks of investing with a borrower that is, or may become, unable to repay. It therefore adopted a strategy for 2011/12 that did not concentrate its investments with the Government's Debt Management Office which are effectively risk-free, as they are backed by the Government, but with a significantly below base interest rate, and instead concentrated on highly rated institutions and the larger Building Societies. At the same time investments in "liquidity accounts" which offer repayment the same day were maximised to further reduce risk.

The 2011/12 Strategy allowed for borrowing in anticipation of need to fund capital expenditure although that option has not so far been used this year.

CURRENT POSITION
Investment Portfolio
The Council's position as at 31 December 2011 was:

INVESTMENTS	Principal Amount £m	Average Interest Rate %
Investments - maturing 2011/12	14	1.3
Investments - maturing later	10	4.4
Total	**24**	**2.6**
Short term Debt	0	0
Long term Debt	10	3.9
Total	**10**	**3.9**
Net Investments	**14**	**1.7**

Budget implications
The budget for net interest received in 2011/12 was £93K; as a result of slippage in the capital programme and underspendings in the revenue budget, the forecast outturn is £202K. The budget for net interest received in 2012/13 is £11K.

THE COUNCIL'S FINANCIAL STRATEGY

The table below shows the expected levels of reserves and the need for borrowing to fund capital expenditure over the MTP period.

If the Council's own reserves are used to temporarily finance capital expenditure there could be a need to borrow a further £14M by March 2013. There will be periods where this need will be off-set by the daily and weekly cash flow fluctuations whereby Council Tax and Government Grant is received in advance of precept payments being due to the County Council, Police Authority and Fire Authority.

MAY borrow figures are based on our agreement with our previous external auditors that it would be legitimate to borrow in advance to fund our 5 year published capital programme if market circumstances indicated that this was likely to be in the long term interests of the Council.

	2011/ 2012 £M	**2012/ 2013 £M**	**2013/ 2014 £M**	**2014/ 2015 £M**	**2015/ 2016 £M**	**2016/ 2017 £M**
SUMS AVAILABLE TO FUND CAPITAL EXPENDITURE						
Existing long term borrowing	**10.0**	**10.0**	**10.0**	**10.0**	**10.0**	**10.0**
available long term						
Revenue Reserves (EOY)	12.0	9.4	7.5	5.6	4.5	4.5
Provision for repaying loans (EOY)	0.9	1.8	2.9	4.2	5.8	7.6
Earmarked Reserves (EOY) ❶	3.6	3.6	3.6	3.6	3.6	3.6
available on a year by year basis	**16.5**	**14.8**	**14.0**	**13.4**	**13.9**	**15.7**
Cash Flow benefit average	**9.6**	**9.6**	**9.6**	**9.6**	**9.6**	**9.6**
fluctuates from day to day						
FUNDING REQUIRED						
Capital Expenditure						
Brought Forward	18.5	23.4	33.8	37.4	40.0	43.5
Capital Expenditure in Year	4.9	10.4	3.6	2.6	3.5	2.5
Carried Forward	**23.4**	**33.8**	**37.4**	**40.0**	**43.5**	**46.0**
Fixed Term Investment (EOY)❷	**10.0**	**5.0**				
Total Required Funding	**33.4**	**38.8**	**37.4**	**40.0**	**43.5**	**46.0**
NEED FOR FURTHER BORROWING						
Excluding Cash flow benefit						
MUST BORROW	**6.9**	**14.0**	**13.4**	**16.6**	**19.6**	**20.3**
MAY BORROW	**36.0**	**41.0**	**38.4**	**41.3**	**44.3**	**47.5**
Including average Cash flow benefit						
MUST BORROW	**0.0**	**4.4**	**3.8**	**7.0**	**10.0**	**10.7**

Notes

❶ includes specific earmarked reserves (e.g. S106 and R&R Funds)

❷ takes account of fact that the £5m of the £10M borrowed in anticipation is invested until December 2012 and £5M to December 2013.

BORROWING - CASH FLOW

In addition to the fundamental movements described above there are day-to-day impacts due to the flow of funds into and out of the Council. For instance, the dates on which the County Council is paid its portion of the council tax will be different to the days the money is physically received from Council Tax payers. These cash flows will sometimes leave the Council with several million pounds to borrow or to invest overnight or for a few weeks pending the next payroll or precept date.

Authorities are permitted to borrow short term for this purpose and funds are obtained from whoever is quoting the lowest rate for the period required. If rates are particularly high on a particular day then the sum may be borrowed overnight to see if rates are lower the following day for the remainder of the period required.

BORROWING – CAPITAL – MUST borrow

The amount of capital borrowing up until March 2013 (i.e. up to an estimated £14M) will be dependent upon the actual levels of revenue spending which will determine the level of the Council's own reserves that can be used and the level of capital spending which will determine the total sum required. The period of borrowing will reflect the current and anticipated interest rate profile. If short term interest rates began to rise consideration would be given to whether long term rates were attractive enough to support long term borrowing. If rates remain low it is much more difficult to justify long term borrowing.

BORROWING – CAPITAL – MAY borrow

The MAY borrow limits assume that no use is made of reserves for funding and also that it has become attractive to fund the 5 year capital programme in advance. Deciding to go beyond the MUST borrow level would require longer term borrowing rates to be at levels that appeared to be attractive when compared with rates that were expected over the remainder of that period. It would also need to take account of the difference between the borrowing rates and the, currently, much lower investment rates that would be received pending the use of the money for funding capital from sufficiently secure counterparties. A risk assessment will be carried out before undertaking any advance borrowing.

For example, if long term rates fell to 3.5% we would seriously consider increasing borrowing whilst if long term rates were 5.5% only the MUST borrow limits would be followed.

Currently low short-term rates reduce the likelihood of advance borrowing as the revenue budget would have to 'take the hit' of the borrowing rates being higher than the temporary investment rate in the short to medium term.

However, history has shown that violent fluctuations can happen and so there needs to be the freedom to act if circumstances significantly change.

BORROWING - PROFILE

It is best practice to pool all funds and model future cash flow before determining the amounts that should be borrowed or invested and for how long. In doing this account will be taken of the provision that the Council is required to build up each to fund the repayment of debt.

The Council will be balancing two different aspects when deciding on the period it will borrow for:

- Stability. Avoid the risk of market movements affecting the borrowing cost adversely. To do this the logical option is to borrow the money for as long as needed.

- Lowest Cost. Minimise the overall cost of borrowing which, at the present time, might result in very short borrowing because of the very low interest rates available. However, future rates may rise significantly meaning that it was better to have paid more initially and borrowed longer.

The logical result is to spread the risk by borrowing for a range of periods. However, given the Council's current financial position it may be that, until interest rates have returned to normal relativities or there is sufficient certainty that they will do so, the Council should use its revenue reserves and/or borrow short term for rates that are currently under 1%.

Any long term borrowing will tend to be from the Public Works Loans Board (PWLB) which is a Government Agency providing funds to local authorities at interest rates linked to the cost of central government borrowing. Commercial bodies have become less involved since the financial crisis and their products were generally for shorter periods and often include embedded options. The most common was a LOBO, where the lender retains an option to increase the interest rate after a number of years and the borrower has the right to repay if the new rate is not acceptable.

The Council will need to approve a prudential indicator for the 'authorised limit for external debt'; which combines:

- temporary borrowing for cash flow purposes (£20M)
- long-term borrowing to fund capital expenditure of £46M (up to the £36M "may borrow" limit plus the £10M already borrowed)
- an allowance for other long-term liabilities, such as finance leases (£5M).

A maximum of **£71M** is therefore recommended.

INVESTMENTS - CATEGORIES

The guidance on Local Authority Investments categorises investments as 'specified' and 'non-specified'.

Specified investments are expected to offer relatively high security and/or liquidity. They must be:

- in sterling (avoiding exchange rate fluctuations) **and**,
- due to be repaid within 12 months (minimising capital value fluctuations on gilts and CDs and minimising the period within which a counterparty might get into difficulty) **and**,
- **not** defined as capital expenditure in the capital finance regulations 2003 (e.g. equities and corporate bonds though there is current consultation on removing bonds from the capital constraint)) **and**,
- with a body that the Council considers is of high credit quality or with the UK Government or a local authority. (minimising the counterparty risk), this includes Money Market Funds where the Council has set minimum criteria.

These include time-deposits for up to 1 year with building societies and banks which the Council deems to have a high credit quality (see below), but it should be noted that early repayment, before the due date is rarely possible and may require a release fee.

No investment that counts as Capital expenditure will be undertaken as it effectively transfers revenue funds into capital when the investment is repaid which has significant impacts on the Council's financial flexibility.

Non-specified investments include longer deposits and other types of investment e.g. corporate bonds and equities.

The Council may use the following non-specified investments:

- Time Deposits of longer than 12 months with banks and building societies
- UK government bonds, supranational bank bonds, loans to other local authorities over 12 months to maturity
- Corporate Bonds over 12 months to maturity, if returns are clearly better than time deposits, but such investments will only be made following a risk assessment and consultation on the proposed limits, procedures and credit ratings with the Treasury Management Advisory Group. Use would be limited to Bonds that could be held to maturity thus avoiding fluctuations in capital value.

INVESTMENTS – HIGH CREDIT QUALITY

The term 'high credit quality' is used in the CLG guidance to encourage local authorities to monitor other measures of an institution's creditworthiness rather than just relying on credit ratings

CIPFA has issued guidance on possible sources of additional information in order to assess the credit worthiness of counterparties which are referred to below.

Whilst the Council will take some account of such additional information the main criteria for judging credit quality will be:

- Short term credit ratings (Definitions in Appendix A)
- Long-term credit ratings for any investment over 1 year. (Appendix A)
- The top 25 Building Societies by asset size irrespective of any credit rating they may hold subject to the comments below. Building societies have a much higher proportion of their funds covered by retail savings so are less at the risk of market volatility and their regulatory framework and insolvency regime means that the Council's deposits would be paid out before retail depositors. Experience in recent years includes a number of examples of the takeovers of weak societies by strong ones. However any Building Society with a rating of less than BBB will not be used and use will be suspended of Building Society with a "rating watch" warning pending consideration of further information of the potential impact.
- Reacting immediately to any "rating watch" warnings or informal comments from our advisors in relation to market concerns. Use of counterparties subject to such warnings/advice will be suspended pending consideration of further information of the potential impact.
- Credit Default Swap prices obtained from our advisors.
- The credit rating of the country of the institution. This must be AA or above.

Financial statements and the financial press will not be systematically reviewed because the resources required are not available and it is expected that our advisors will make informal comments if they become aware of any significant items that affect our counterparty list. They also review our counterparty list every month.

INVESTMENTS – SPREADING THE RISK
Credit quality can never be absolutely guaranteed so to further mitigate risks there is a need to spread investments in a number of ways:

- By counterparty, including any institutions that are linked in the same group
- By Country

These limits need to be a practical balance between safety and administrative efficiency and need to cope with the uncertainty of the amount of borrowing in anticipation. A table is therefore included in Appendix B which shows the limits for different levels of forward borrowing.

INVESTMENTS – PERIODS
Once a time deposit is made there is no requirement for the borrower to repay until the end of the agreed period. Thus a borrower who has a high credit rating on the investment day could be in serious financial difficulties in the future. As a result significant use is made of liquidity accounts which currently give an attractive interest rate but also allow repayment of our investment the same day.

The Council will register with a selection of money market funds with AAA ratings which also allow same-day withdrawal of funds. These will be used as appropriate taking account of comparative security and yields.

INVESTMENTS - MANAGEMENT

Taking account of the Credit Quality and Spreading the Risk sections above Appendix B outlines the criteria and limits for making investments.

There may be limited occasions, based on detailed cash flow forecasts, where some investments of more than a year might be made that do not relate to borrowing in anticipation.

Risk of counterparty failure can also be minimised by shortening the period of any time deposit. At the current time, partly reflecting the current interest rate structure, time deposits are generally kept below one month. The criteria also differentiates the duration of investments based on credit rating e.g. the maximum duration of investments with building societies with no rating will be 1 month.

Advantage is also being taken of liquidity accounts which are offering competitive rates for money on call i.e. it can be called back the same or next day if there was any concern about the institution.

POLICY ON USING FINANCIAL DERIVATIVES

Local authorities have previously made use of financial derivatives embedded in 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. lenders option/borrowers option (LOBO) loans).

The Localism Bill 2011 includes a general power competence that removes the uncertain legal position over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). The latest Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. It is unlikely that the Council will utilise standalone financial derivatives.

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. The Council is only likely to make limited use of embedded derivatives e.g. LOBOs

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.

ADVISORS

The Council appointed Sterling Consultancy Services as Treasury Management Advisors in January 2008 (following retendering they were reappointed in January 2011), however responsibility for final decision making remains with the Council and its officers

The Advisor carries out the following role:

- advice on investment decisions,
- notification of credit ratings and changes,
- general information on credit quality and informal comment on particular institutions,
- advice on borrowing and opportunities to borrow early
- economic data and interest rate forecasts
- advice and guidance on relevant policies, strategies and reports,
- accounting advice,
- reports on treasury performance,
- training courses.

The quality of the service is controlled by regular contact between the Advisors and officers.

MANAGEMENT

The Head of Financial Services and his staff will manage and monitor investments and borrowing.

The Treasury Management Advisory Group (TMAG) consists of four members; they are kept informed of relevant issues and consulted on any significant issues.

The Council uses a cash flow model which is updated daily to forecast future cash flow movements to determine the maximum length for which any investment could be considered. The length of any investment would take account of actual and forecast interest rates over the loan period to ensure it optimises the Council's position. The Council is unlikely to invest for more than a year unless further advance borrowing is undertaken.

REPORTING AND SCRUTINY

The CIPFA Code requires that the body responsible for approving the budget also receives at least two reports during the year on treasury management. Therefore the Council will receive a six month report on the performance of the funds and an annual report on the performance for the year.

The Code also requires the Council to identify the body that will be responsible for the scrutiny of treasury management to ensure that it receives the appropriate focus. This is the Economic Well-being Overview & Scrutiny Panel.

TRAINING

The needs of the Council's treasury management staff for training are assessed every six months as part of the staff appraisal process and additionally when the responsibilities of individual staff change. As the result of the voluntary redundancy of a Senior Accountant in September 2011 and a reorganisation of the Accountancy Section, a Principal Accountant has been given the responsibility for day-to-day management of the treasury function. He has attended a number of courses provided by Sterling Consultancy Services

The Code requires that Members charged with the governance of Treasury Management and those responsible for scrutiny have the necessary skills relevant to their responsibilities. Member training will be provided as necessary.

CHANGES TO THE STRATEGY

The strategy is not intended to be a strait-jacket but a definition of the upper limit of the level of risk that it is prudent for the Council to take in maximising the return on its net investments. Any changes that are broadly consistent with this Strategy and either reduce or only minimally increase the level of risk, are delegated to the Head of Financial Services, after consultation with the Treasury Management Advisory Group, where of any significance. All other changes to the strategy must be approved by the full Council.

TREASURY MANAGEMENT AND PRUDENTIAL INDICATORS

The Council's Treasury Management and Prudential Indicators are attached at Appendix C. They are based on data included in the budget report and this Strategy. They set various limits that allow officers to monitor its achievement. These indicators must be approved by the Council and can only be amended by the Council.

The indicators are based on allowing the ability to borrow in advance if this becomes attractive. If it does not, the Council is likely to be significantly within many of the limits.

APPENDIX A

Definition of Credit Ratings

	Rating	Definition	Examples of counterparties
Short term (Fitch)	**F1**	Indicates the strongest intrinsic capacity for timely payment of financial commitments; may have an added "+" to denote any exceptionally strong credit feature.	Royal Bank of Scotland/NatWest (F1) Coventry Building Society
	F2	Good intrinsic capacity for timely payment of financial commitments.	Co-operative Bank
	F3	The intrinsic capacity for timely payment of financial commitments is adequate.	Skipton Building Society
Long-term (Fitch)	**AAA**	Highest credit quality. 'AAA' ratings denote the **lowest expectation of default risk.** They are assigned only in cases of exceptionally strong capacity for payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.	United Kingdom
	AA	Very high credit quality. 'AA' ratings denote **expectations of very low default risk.** They indicate very strong capacity for payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.	HSBC Bank
	AA-		Standard Chartered Bank
	A	**High credit quality.** 'A' ratings denote expectations of low default risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to adverse business or economic conditions than is the case for higher ratings.	Coventry Building Society
	A-		Leeds Building Society

The modifiers "+" or "-" may be appended to a rating to denote relative status within major rating categories.

APPENDIX B

IN-HOUSE FUND MANAGEMENT (IF NO FURTHER ADVANCE BORROWING)

Duration of investments	No investment shall be longer than 5 years. Maximum duration for a Building Society with no rating is 1 month.
Types of investments	Fixed term Deposits Deposits at call, two or seven day notice Corporate bonds Money market funds UK Government bonds and Supranational Bank bonds.
Credit Ratings	**Building Societies** All Building Societies with ratings of BBB or above. Building Societies with no ratings. **Money Market Funds** AAA credit rating **Local Authorities or UK Government** No rating required **Non-Building Societies** Short term rating F1 by Fitch or equivalent. Long-term rating of AA- by Fitch or equivalent if the investment is longer than 1 year.
Maximum limits per counterparty (group), country or non-specified category	F1+ or have a legal position that guarantees repayment for the period of the investment — £5M F1 — £4M Building Society with assets over £2bn in top 25 (Currently 10) — £5M Building Society with assets over £1bn if in top 25 (Currently 3) — £4M Building Society with assets under £1bn in top 25 — £3M Liquidity (Call) Account with a credit rating of F1+ or with a legal position that guarantees repayment or a Building Society. — £5M BUT total invested with counterparty/group shall not exceed — £8M Money market fund AAA Credit rating — £4m **Limit for Non-specified investments** – £10M in time deposits more than one year – £5M in corporate bonds – £10M in any other types. – £15M in total **Country limits** – UK - unlimited – £5M in a country outside the EU – £10M in a country within the EU (excluding UK) – £20M in EU countries combined (excluding UK) No investment will be made in country with a sovereign rating of less than AA. These limits will be applied when considering any new investment from 23 February 2012. Lower limits may be set during the course of the year or for later years to avoid too high a proportion of the Council’s funds being with any counterparty.
Benchmark	LGC 7 day rate

INVESTMENT LIMITS FOR INCREASES IN ADVANCE BORROWING			
	Level of Borrowing in Anticipation		**Rating Constraints**
from	£5M	£11M	
to	£10M	£20M	
SPECIFIED INVESTMENTS			
BUILDING SOCIETIES			
Assets over £2bn	£5M	£5M	
Assets over £1bn	£4M	£4M	
Rest of top 25 by assets	£3M	£3M	
BANKS & OTHER INSTITUTIONS			
F1+ or legal status	£5M	£5M	AA- if more than 1 year
F1	£4M	£4M	AA- if more than 1 year
LIQUIDITY ACCOUNTS			F1+or legal status
Limit in liquidity account	£5M	£6M	
Limit with any other investments in institution	£8M	£9M	
NON-SPECIFIED INVESTMENTS			
Time Deposits over 1 year in total	£20M	£30M	
Corporate Bonds in total	£5M	£8M	Not yet determined
Total	£20M	£30M	
TERRITORIAL LIMITS			
UK	Unlimited		
EU (excluding UK)	£20M	£20M	
EU Country (other than UK)	£10M	£10M	
Any other Country	£5M	£5M	

APPENDIX C

CIPFA Prudential Code for Capital Finance in Local Authorities
Prudential Indicators and Treasury Management Indicators for 2012/13

1. Actual and Estimated Capital Expenditure

	2010/11 Actual £000	2011/12 Forecast £000	2012/13 Estimate £000	2013/14 Estimate £000	2014/15 Estimate £000
Gross	**9.2**	**9.1**	**19.5**	**6.9**	**4.1**
Net	**7.5**	**4.9**	**10.4**	**3.6**	**2.6**

2. The proportion of the budget financed from government grants and council tax that is spent on interest and the provision for debt repayment.

The negative figure in 2010/11 reflects that the Authority was a net investor and that the net interest earned exceeded the provision for the repayment of debt.

2010/11 Actual	2011/12 Forecast	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
-0.3%	**1.9%**	**4.1%**	**6.1%**	**7.8%**

3. The impact of schemes with capital expenditure on the level of council tax

This calculation highlights the hypothetical impact on the level of Council Tax from changes from the previously approved MTP due to capital schemes (including their associated revenue implications).
The actual change in Council Tax will be significantly different due to revenue variations, spending adjustments and the use of revenue reserves.

	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Variation	**-£3.41**	**+£3.80**	**-£1.92**
Cumulative	**-£3.41**	**+£0.39**	**-£1.53**

4. The capital financing requirement.

This represents the estimated need for the Authority to borrow to finance capital expenditure less the estimated provision for redemption of debt (the MRP) with no allowance for funding in advance.

31/3/11 Actual £M	2011/12 Forecast £M	2012/13 Estimate £M	2013/14 Estimate £M	2014/15 Estimate £M	2015/16 Estimate £M	2016/17 Estimate £M
18.2	**22.5**	**32.0**	**34.5**	**35.8**	**37.7**	**38.4**

5. Net borrowing and the capital financing requirement

In order to ensure that, over the medium term, net borrowing will only be for a capital purpose, the Authority should make sure that net external borrowing (borrowing less investments) does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

The Council will explain the degree of borrowing and investment in its half-year and annual reports together with the reason for the movements so that Members can be assured that there is no borrowing for revenue purposes other than in the short term.

5a. Gross and Net Debt

This indicator (a new requirement this year) is intended to highlight the level of advance borrowing by limiting the variation between gross debt (borrowing) and net debt (borrowing less investments). The more borrowing in advance the higher the gross debt but there is no change in net debt because the borrowed sums will be invested pending them being needed to finance capital expenditure. Thus net debt as a proportion of gross debt falls as borrowing in advance occurs.

Unfortunately the position is complicated by the significant variations that the Council has to contend with relating to day-to-day cash flow which can cause major fluctuations in this proportion.

Guidance has not been issued on the practical use of this indicator and so there seems little point in setting one this year.

To achieve the equivalent result all advance borrowing will be reported to the Treasury Management Advisory Group and highlighted in the mid-year and end of year reports.

6. The actual external long-term borrowing at 31 March 2011
£10m

7. The authorised limit for external debt**.**

This is the maximum limit for borrowing and is based on a worst-case scenario. It reflects the Treasury Management Strategy which allows the Authority to borrow in advance to fund future capital expenditure.

	2011/12 Limit £M	2012/13 Limit £M	2013/14 Estimate £M	2014/15 Estimate £M
Short term	20	20	20	20
Long Term assuming maximum borrowing in advance	40	51	48	51
Other long-term liabilities (leases)	5	5	5	5
Total	**65**	**76**	**73**	**76**

8. The operational boundary for external debt.

This reflects a less extreme position. Although the figure can be exceeded without further approval it represents an early warning monitoring device to ensure that the authorised limit (above) is not exceeded. The short term and long term element will be monitored separately.

	2012/13 Limit £M	2013/14 Limit £M	2014/15 Limit £M
Short term	15	15	15
Long term	41	38	41
Other long-term liabilities (leases)	5	5	5
Total	**61**	**58**	**61**

9. Adoption of the CIPFA Code

The Council has adopted the 20011 edition of the CIPFA Treasury Management Code of Practice.

TREASURY MANAGEMENT INDICATORS

10. Exposure to interest rate risk as a proportion of net investments. This indicator is set to control the Council's exposure to interest rate risk. Investments of less than 12 months count as variable rate.

If the Council does not borrow in advance it is quite possible that all investments, except for the current fixed investment of £5M to December 2013, will be of less than a year's duration and hence count as "variable rate".

Conversely, if the Council does borrow in advance there could be periods where the Council's cash flow requires short term borrowing and so all investments are longer than one year.

Accordingly, to ensure the necessary flexibility the indicators all need to be 100% except for the 2012/13 variable rate which is reduced to 85% to reflect the £5M investment due for repayment in December 2013.

	2012/13	2013/14	2014/15
Upper limit on fixed rate exposure	**100%**	**100%**	**100%**
Upper limit on variable rate exposure	**90%**	**100%**	**100%**

11. Borrowing Repayment Profile

The proportion of borrowing in place during 2012/13 that will mature in successive periods. This indicator is set to control the Council's exposure to refinancing risk.

The Council has £10M long term borrowing but the uncertainty on whether any forward borrowing will take place and the potential for short term borrowing to be the most attractive option results in the limits set out below.

Funding capital schemes	Upper limit	Lower limit
Under 12 months	**86%**	**0%**
12 months and within 24 months	**86%**	**0%**
24 months and within 5 years	**86%**	**0%**
5 years and within 10 years	**86%**	**0%**
10 years and above	**100%**	**14%**

12. Investment Repayment Profile

Limit on the value of investments that cannot be redeemed within 364 days i.e. by the end of each financial year. The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. These limits need to allow for borrowing in advance.

The uncertainty about borrowing in advance results in higher limits than would otherwise be required.

	2012/13 £M	2013/14 £M	2014/15 £M
Limit on investments over 364 days as at 31 March each year.	**32.0**	**25.0**	**24.7**