

Decision maker: Cabinet

Agenda item:

Subject: Treasury Management Monitoring Report for the First Quarter of 2012/13

Date of decision: 17 September 2012 (Cabinet)
27 September 2012 (Governance and Audit Committee)

Report by: Head of Financial Services & Section 151 Officer

Wards affected: All

Key decision: No

Budget & policy framework decision: No

1. Summary

The Chartered Institute of Public Finance and Accountancy (CIPFA) defines Treasury Management as “The management of the organisation’s 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”. The risks associated with treasury management include credit risk, liquidity risk, interest rate risk and refinancing risk. The report contained in Appendix A reports on the City Council’s treasury management position as at 30 June 2012.

2. Purpose of report

The purpose of the report in Appendix A is to inform members and the wider community of the Council’s Treasury Management position at 30 June 2012 and of the risks attached to that position.

3. Background

In March 2009 the CIPFA Treasury Management Panel issued a bulletin on Treasury Management in Local Authorities. The bulletin states that “in order to enshrine best practice it is suggested that authorities report formally on Treasury Management activities at least twice yearly and preferably quarterly”. The report in Appendix A covers the first three months of 2012/13

4. Recommendations

That the following actual treasury management indicators for the first quarter of 2012/13 be noted:

- (a) The Council’s sums invested for periods longer than 364 days at 30 June 2012 were:

	Prudential Limit	Quarter 1 Actual
	£m	£m
Maturing after 31/3/2013	110	72
Maturing after 31/3/2014	90	10
Maturing after 31/3/2015	80	0

- (b) The Council’s fixed interest rate exposure at 30 June 2012 was £290m, ie. the Council had net fixed interest rate borrowing of £290m
- (c) The Council’s variable interest rate exposure at 30 June 2012 was (£180m), ie. the Council had net variable interest rate investments of £180m
- (d) The maturity structure of the Council’s borrowing was

	Under 1 Year	1 to 2 Years	3 to 5 Years	6 to 10 Years	11 to 20 Years	21 to 30 Years	31 to 40 Years	41 to 50 Years
Actual	1%	4%	3%	5%	9%	12%	8%	58%

5. Implications

The net cost of Treasury Management activities and the risks associated with those activities have a significant effect on the City Council's overall finances. Effective Treasury Management provides support to the organisation in the achievement of its business and service objectives.

6. Corporate priorities

This report and the activities it refers to contribute to the following Corporate Priority:

- Improve efficiency and encourage involvement

7. Equality impact assessment (EIA)

A preliminary equalities impact assessment on Treasury Management Policy was carried out in March 2012 .

8. Legal implications

The Section 151 Officer is required by the Local Government Act 1972 and by the Accounts and Audit Regulations 2011 to ensure that the Council's budgeting, financial management, and accounting practices meet the relevant statutory and professional requirements. Members must have regard to and be aware of the wider duties placed on the Council by various statutes governing the conduct of its financial affairs.

9. Head of Finance's comments

All financial considerations are contained within the body of the report and the attached appendices



.....
Signed by Head of Financial Services

Appendices:

Appendix A: Treasury Management Monitoring Report

Background list of documents: Section 100D of the Local Government Act 1972

The following documents disclose facts or matters, which have been relied upon to a material extent by the author in preparing this report:

<u>Title of document</u>	Location
1 Treasury Management Files	Financial Services
2	

The recommendation(s) set out above were approved/ approved as amended/ deferred/ rejected by the Cabinet on 17 September 2012.

.....
Signed by: the Leader of the Council

**TREASURY MANAGEMENT MONITORING REPORT FOR THE FIRST QUARTER OF
2012/13**

1. GOVERNANCE

The Treasury Management Policy Statement, Annual Minimum Revenue Provision for Debt Repayment Statement and Annual Investment Strategy approved by the City Council on 20 March 2012 (attached as Appendix 1) provide the framework within which treasury management activities are undertaken.

2. ECONOMIC BACKGROUND

The Council's employs Sector to provide economic advice. Sector have provided the following summary of the current economic background:

- The economic outlook has generally weakened;
- Demand on the high street was volatile, as a result of temporary distortions;
- Employment rose and unemployment fell, but earnings growth remained weak;
- Inflation continued to fall;
- The Bank and the HM Treasury announced measures to help the UK banking sector;
- The MPC indicated another tranche of quantitative easing (QE);
- Gilt yields fell on the back of deteriorating economic data and safe-haven flows from the euro-zone;
- Sentiment towards the Eurozone alternately rose on the announcement of measures to address the crisis, but then fell back as measures disappointed.

The weakening business surveys since the start of Q1 suggests that the economy will be lucky to escape a third successive quarterly contraction (output shrunk by 0.4% in Q3 FY 11/12 and 0.3% in Q4 FY 11/12). Admittedly, the weighted output balance of the CIPS/Markit surveys in April and May was at a level consistent with quarterly expansion, albeit of only 0.2%. However it is not clear that the CIPS surveys have improved on the detrimental impact on output of the extra bank holiday for the Queen's Jubilee at the start of June.

The CIPS surveys do exclude the retail sector and high street spending, which performed strongly in May on the official measure, following a weak, poor-weather driven performance in April. Evidence for early June from the CBI's Distributive Trades Survey suggests that the Jubilee holiday may have boosted spending. Nevertheless, consumer confidence showed no signs of breaking out of its long-depressed state.

The labour market continued to perform relatively better. The Labour Force Survey measure of employment rose by 166,000 in the three months to April, whilst unemployment fell by 51,000 in the period February-April. The scale of the decline was more modest than the rise in employment, with the number of people looking for work outpacing jobs growth. The narrower claimant count measure of unemployment did rise by 8,000 in May, the largest increase since September 2011.

Pay growth remained weak. Annual growth of overall average earnings rose from 0.8% to 1.9% in April as the poor bonus season ended. Excluding bonuses, growth was only 1.8%. Given the rate of inflation over this period, real pay continued to fall on an annual basis, an underlying drag on the consumer and therefore growth.

House prices trended downwards. The Nationwide measure fell in two of the three months from April to June, with the annual rate of house price inflation declining from -0.7% in May to -1.5% in June. The less timely Halifax measure also saw an overall decline in prices over April and May.

Banks' funding costs eased over the quarter, reflecting actions by the Bank of England and Treasury to boost liquidity. Two initiatives were announced in June - a 'funding for lending' scheme which would allow banks to temporarily "swap" their assets with the Bank of England in return for money they could lend to customers, and an emergency scheme that offered six-month low-cost liquidity to banks in tranches of £5bn a month.

Costs, however, remained elevated and banks began to pass higher costs onto borrowers. Borrowing rates on most types of new mortgages picked up in April and May.

Trade data showed a sharp deterioration in April. The UK posted its second largest monthly trade deficit on record, driven in large part by a widening of the gap between exports and imports with countries outside the EU. Exports to the Eurozone also fell, with weakness extending from the peripheral countries to what had previously been perceived as strong economies like Germany.

The latest public finance figures also disappointed. While April's budget surplus was the largest on record, this was flattered to the tune of £28bn by the transfer of a share of the assets of the Royal Mail's pension fund to the public sector. Once allowance was made for this, net borrowing for the first two months of the financial year was almost £4bn higher than the equivalent period in 2011/12.

Inflation fell further in the second quarter. CPI inflation fell from 3.5% in March to 2.8% in May, driven by declines in fuel and food prices. Core inflation fell from 2.5% to 2.2%.

The most striking development in inflationary pressures was in the price of oil, which fell from \$125 at the beginning of April to around \$96 at the end of June, its lowest level since early 2011.

Consistent with the decline in inflation, medium-term indicators of inflation suggested that underlying price pressures remained weak. Household respondents to June's YouGov/Citigroup inflation expectations survey predicted the annual rate of inflation in a year's time would be 2.4%, the lowest year-ahead expectation since April 2010.

The MPC voted narrowly against pursuing more quantitative easing (QE) at its June meeting. The consensus view was that the MPC would decide on further purchases in July. The Governor of the Bank of England said in June that, as a consequence of the Eurozone crisis, he was already more pessimistic than suggested by the forecasts published in the Bank's Inflation Report only six weeks earlier.

As a result of, safe-haven flows from the Eurozone and the impact of QE, government bond yields fell during the quarter, with ten year yields at one point dropping below 1.5%, their lowest level ever.

After signs of acceleration in Q4 FY 11/12, the US economy's recovery lost momentum. Total non-farm payroll employment was up only 69,000 in May, following a similarly weak rise in April of 77,000. US retail sales values fell in April and May.

Market sentiment towards the Eurozone remained volatile as successive 'rescue packages' first raised, and then disappointed, expectations. The economic news suggested that the Eurozone economy contracted sharply in the second quarter, while Eurozone unemployment rose to 11.1% in May, the highest rate since the creation of the euro in 1999.

3. INTEREST RATE FORECAST

The Council's treasury advisor, Sector, provides the following forecast:

	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.25%	1.50%
5yr PWLB rate	2.10%	2.20%	2.20%	2.30%	2.40%	2.50%	2.60%	2.80%	3.00%	3.20%	3.40%
10yr PWLB rate	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	4.00%	4.20%	4.40%
25yr PWLB rate	4.20%	4.30%	4.30%	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%
50yr PWLB rate	4.30%	4.40%	4.40%	4.50%	4.60%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%

The Sector central forecast is for the first increase in Bank Rate to be in the first quarter of 2014 but there is downside risk to this projection. With growth predictions for the U.K continuing to be reduced on an almost monthly basis by both the Office for Budget Responsibility and economic commentators generally, and financial markets unconvinced that politicians have resolved the Euro-zone sovereign debt crisis in the medium-term, we are likely to continue to experience high levels of volatility.

The outlook for the global economy remains clouded with uncertainty. The UK economy has struggled to generate a sustained recovery so this offers little hope for a strong recovery in 2012, and possibly even into 2013. Consumer and business confidence levels are generally low and it is not easy to see potential for a significant increase in the growth rate in the short term.

Euro-zone

- Regular Euro-zone summits have yet to put in place the building blocks for a long-term recovery;
- The outcome of the French and Greek elections have emphasised the desire of the southern nations and France to see more of a growth agenda than has been prevalent of late and also a potential move towards fiscal union;
- Cash outflows from banks have generally been from the southern nation states to Germany, Holland, Denmark and Finland.
- The Germans remain reticent about fiscal union of any sort;
- In the first week of July, the ECB cut the base lending rate to 0.75% from 1% whilst the deposit rate was reduced to zero.

US

- Economic prospects have disappointed in recent weeks with the key non-farm payroll monthly figures tending to dip below 100,000 new jobs. For a proper, robust recovery, something in the order of 200,000 new jobs needs to be created each month.
- Operation Twist remains in place, ensuring that long term funding costs are forced down as well as the loose monetary policy at the short end of the curve;
- However, in a typically fraught election year, the US still has to address reducing the huge total of public debt and annual deficits but that will have to wait until 2013 at the earliest;
- Presidential elections are due in November 2012.

China

- Falling inflation has opened the way for relaxing credit restrictions to boost growth, which has been flagging;
- Current expectations are that it will maintain a reasonable rate of growth, though less than in previous years.

UK

- Austerity measures, aimed at getting the public sector deficit into order over the next four years, may start losing support unless the economy starts to revive soon;
- Some £80bn is going to be made available by the Government to the banks to parcel through to business but it is not clear that all of this will be taken up;
- The housing market, a gauge of consumer confidence, remains subdued although house prices are being supported by the weak £ relative to some of the other main currencies;
- Economic forecasts for 2012 and beyond have been revised lower on a near quarterly basis;
- The Bank of England embarked on a £50bn third round of Quantitative Easing (QE) at the start of July to stimulate economic activity. It is unlikely to be the last tranche of QE and the total now stands at £375bn;
- Inflation has eased from its peak of 5.2% (CPI) in September 2011, now standing at 2.8% with the outlook brighter given commodity and oil prices seem to be in decline, at least for the moment
- “Safe haven” status has underpinned demand for gilts and kept yields at historic lows. We are unlikely to see material change in near term.

Sector emphasises that economic forecasting remains difficult with so many external influences weighing on the UK. Key areas of uncertainty include:

- The impact of the Euro-zone crisis on financial markets and the banking sector;
- The impact of the UK Government’s austerity plan on confidence and growth;
- Monetary policy action failing to stimulate growth in western economies;
- The potential for weak growth or recession in the UK’s main trading partners - the EU and US;

The overall balance of risks remains weighted to the downside. Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries. However, near-term, QE is likely to depress yields and further QE thereafter may lead to a reassessment of Sector’s central forecast

Given the weak outlook for economic growth, Sector sees the prospects for any interest rate changes before early 2014 as very limited indeed. There is potential for the start of Bank Rate increases to be even further delayed if growth disappoints.

3. SOURCES OF FINANCE

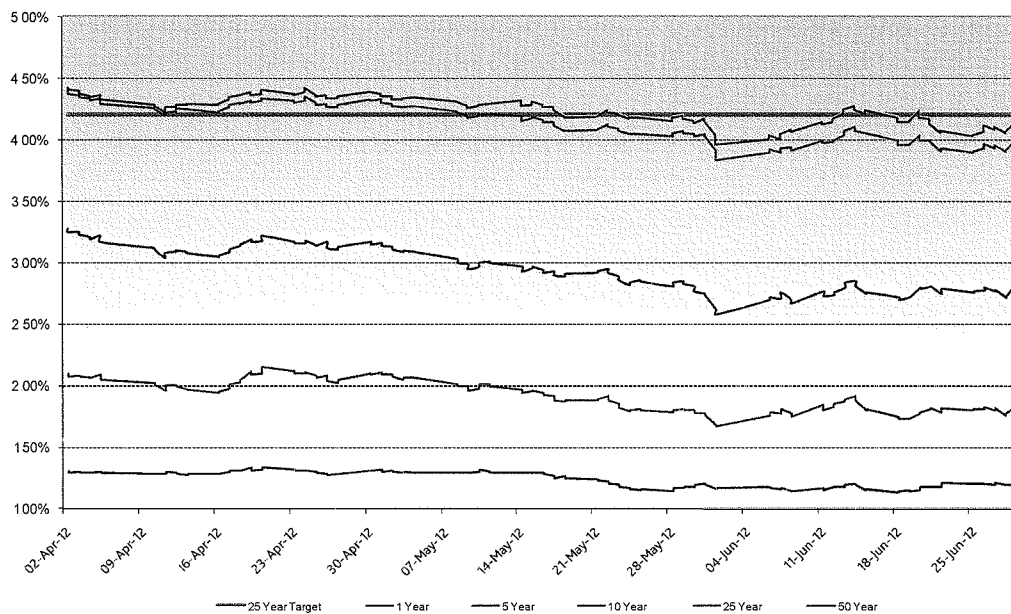
(a) Long Term Borrowing (more than 364 days)

No new borrowing was undertaken during the quarter.

As shown below, interest rates across the interest rate yield curve generally fell during the quarter. The low points during the quarter were generally seen during June.

PWLB rates quarter ended 30.6.2012

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.13%	1.67%	2.58%	3.83%	3.96%
Date	18/06/12	01/06/12	01/06/12	01/06/12	01/06/12
High	1.33%	2.15%	3.28%	4.39%	4.43%
Date	19/04/12	20/04/12	02/04/12	02/04/12	02/04/12
Average	1.24%	1.92%	2.95%	4.13%	4.24%



(b) Borrowing in advance of need

Section 12 of the Local Government Act gives a local authority the power to invest for “any purpose relevant to its functions under any enactment or for the prudent management of its financial affairs”. While the speculative procedure of borrowing purely to invest at a profit is clearly unlawful, there is no legal obstacle to the temporary investment of funds borrowed for the purpose of funding capital expenditure incurred in the reasonably near future.

On 20th March 2012 the Council therefore gave the Head of Financial Services and Section 151 Officer delegated authority to borrow up to £50m in advance of need as measured by the Capital Financing Requirement from 23rd March 2012. This was the estimated borrowing required to support the Council's capital programme until 2016/17.

This was to enable the Council to take advantage of the "special offer" from the Public Works Loans Board of rates typically 1.13% below normal to be used to fund the HRA Self Financing "buy out".

On 28th March the Council borrowed £88.6m from the PWLB at NLF rates. As a consequence the Council's external debt exceeds its estimated capital financing requirement for 2012/13 by £20m.

(c) Debt Rescheduling

Debt rescheduling opportunities have been limited in the current economic climate and structure of interest rates following increases in PWLB new borrowing rates in October 2010. No debt rescheduling was undertaken during the quarter.

(d) Short Term Borrowing Requirements (less than 365 days)

The Head of Finance and Section 151 Officer has delegated powers to undertake long and short term borrowing within an approved limit set by the City Council. The authorised limit for borrowing in 2012/13 of £508m was approved by the City Council on 20 March 2012.

The City Council was in a lending position for the whole of the first quarter of the financial year so this limit was not exceeded at any time and no temporary borrowing was outstanding at the quarter-end.

(e) Long Term Lending

Long term investments at 31 March 2013 are restricted to £110m to ensure that the Council has sufficient cash to meet its requirements.

At the beginning of the quarter the Council had £16m invested long term. Long term investments of £14m matured in the quarter and a further £72m was invested long term so that the Council had £74m invested long term at the end of the quarter. Long term investments now make up 29% of the City Council's investment portfolio. The average return on long term investments was 1.42%. Interest rates on long term investments at 30 June 2012 ranged from 0.95% to 1.96%.

(f) Temporary Lending

The remaining surplus funds were invested in the short term, ie. for less than 365 days. The average return on short-term investments was 0.89%. Interest rates on short-term investments at 30 June 2012 ranged from 0.48% to 3.00%.

4. GROSS AND NET DEBT

The Council's net borrowing position at 30 June 2012 was as follows:

	Prudential Indicator	30 June 2012
	£'000	£'000
Authorised limit for external debt	507,714	507,714
Operational boundary for external debt	484,193	484,193
Gross Debt	484,193	454,366
Investments	(212,140)	(254,048)
Net Debt	272,053	200,318
Capital Financing Requirement at 31 March 2012	434,193	434,193

The Council has a high level of investments relative to its gross debt due to a high level of reserves, partly built up to meet future commitments under the Private Finance Initiative schemes and future capital expenditure. The £88.6m of borrowing taken in 2011/12 to take advantage of the very low PWLB rates has also temporarily increased the Council's cash balances.

The current high level of investments increases the Council's exposure to credit risk, ie. the risk that an approved borrower defaults on the Council's investment. In the interim period where investments are high because loans have been taken in advance of need, there is also a short term risk that the rates (and therefore the cost) at which money has been borrowed will be greater than the rates at which those loans can be invested. The Government has introduced a 1% mark up between PWLB rates and the gilt rates that are used by the PWLB to set its rates. These loans were therefore taken out at rates that have proved to be very favourable. The level of investments will fall as capital expenditure is incurred and commitments under the Private Finance Initiative (PFI) schemes are met.

5. SECURITY OF INVESTMENTS

The risk of default has been managed through investing only in financial institutions that meet minimum credit ratings, limiting investments in any institution to £20m and spreading investments over countries and sectors.

The 2012/13 Treasury Management Policy approved by the City Council on 20 March 2012 only permits deposits to be placed with the Council's subsidiaries, namely MMD (Shipping Services) Ltd, the United Kingdom Government, other local authorities and institutions that have the following credit ratings:

Short Term Rating

F2 (or equivalent) from Fitch, Moody's (P-3) or Standard and Poor (A-3)

Long Term Rating

Triple B (triple BBB category) or equivalent from Fitch, Moody's or Standard & Poor

Viability / Financial Strength Rating

bbb from Fitch or C- from Moody's

Support Rating

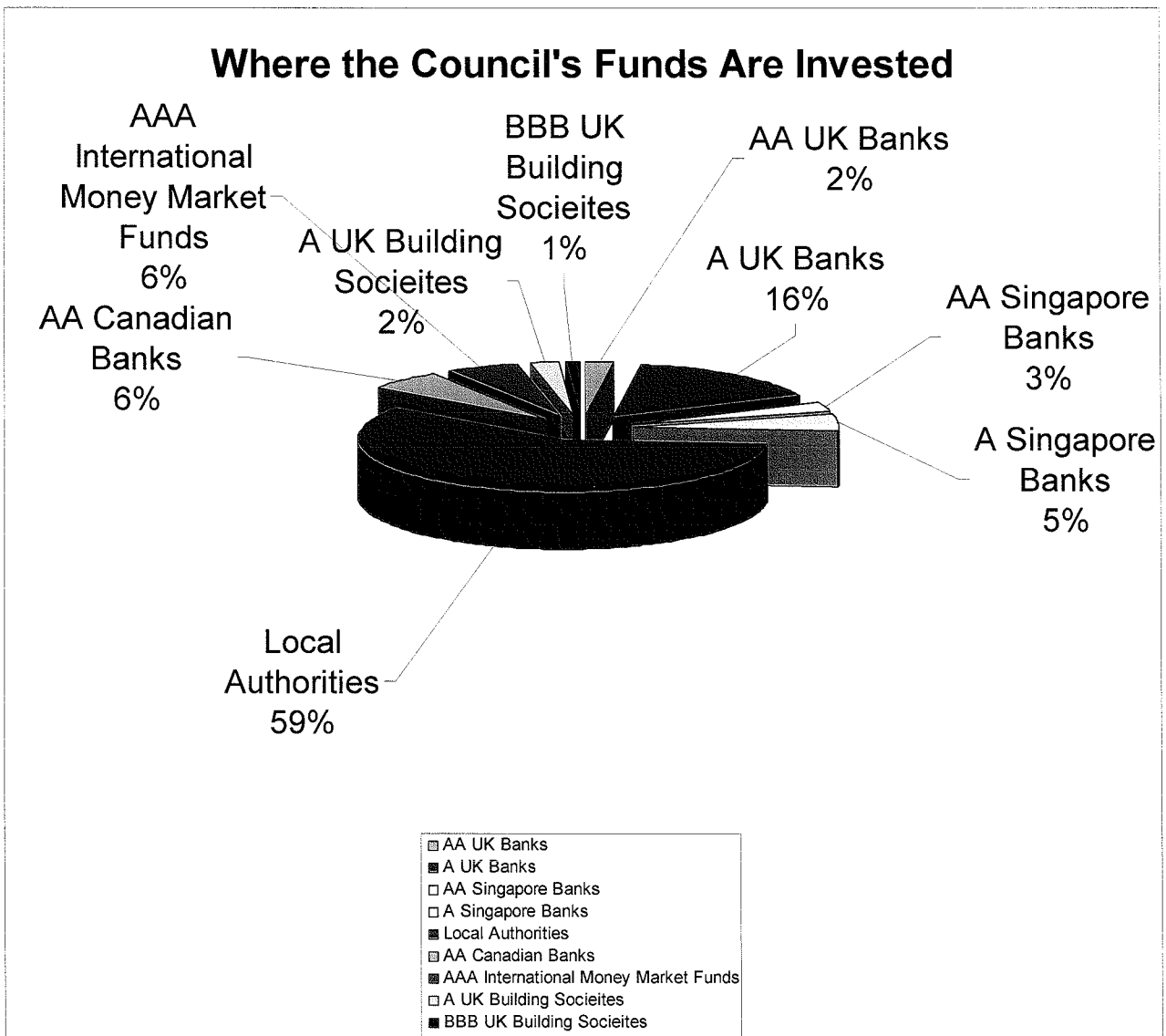
5 from Fitch

Under the Council's Annual Investment Strategy counter parties are categorised by their credit ratings for the purposes of assigning investment limits.

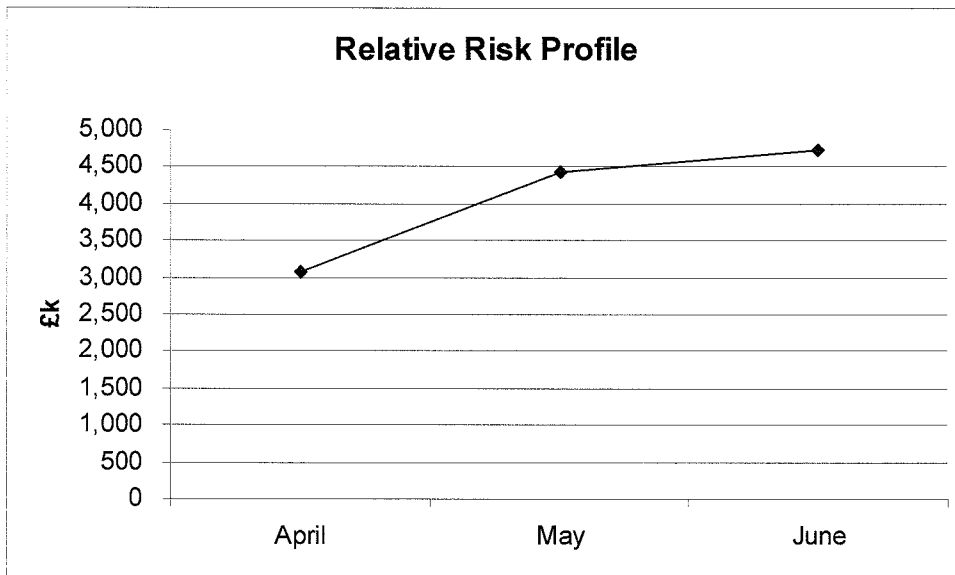
Moody's credit rating agency downgraded Barclays Bank's long term credit rating from Aa3 to A2. Moody's gives the relatively high proportion of revenues from and concentration of risks in global investment banking, and exposure to a weak operating environment in Europe, particularly in Spain and Italy, as well as the UK, as the reason for the downgrade. The effect of the downgrading on the Council's Annual Investment Strategy is to reduce the investment limit for Barclay's from £15m to £10m. The Council currently has £15m invested with Barclays. Consequently 1.97% of the investment portfolio no longer complied with the Council's investment strategy. Once funds have been invested in a fixed term deposit, there is no provision in the contract for funds to be withdrawn prematurely. No further investments will be placed in Barclays until the Council's existing investments fall below the new £10m limit on 1 November 2012.

At 30 June 2012 the City Council had on average £7.9m invested with each institution.

A list of the Council's investments as at 30th June is contained in Appendix 2. The chart below summarises how the Council's funds were invested at 30 June.



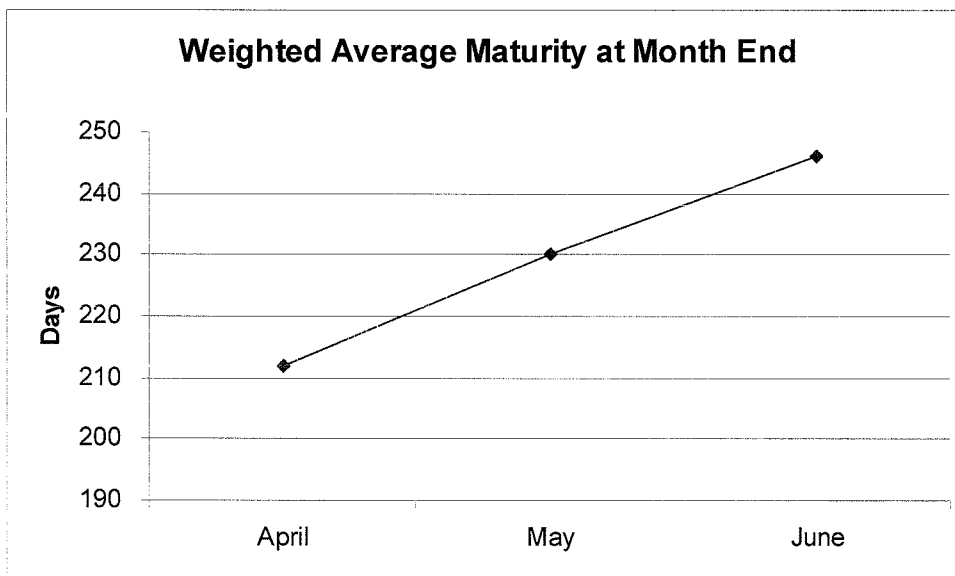
The credit rating agencies publish default rates for each rating category. Multiplying these default rates by the amount invested in each credit rating category provides a measure of risk that can be used as a benchmark to determine whether the City Council's investment portfolio is becoming more or less risky over time as shown in the graph below.



The City Council's investment portfolio became relatively more risky over the first quarter of 2012/13. This is largely due to much less use being made of AAA rated money market funds that pay relatively low levels of interest. Reducing the use of money market funds is also likely to reduce the Council's exposure to the Euro-zone. The above graph should be read in relative terms. A default occurs when sums due are not paid on time. A default does not mean that the sum invested will be lost permanently.

6. LIQUIDITY OF INVESTMENTS

The weighted average maturity of the City Council's investment portfolio started at 212 days in April and increased to 246 days in June as funds were available to invest longer to get a higher return. This is shown in the graph below.



The 2012/13 Treasury Management Policy seeks to maintain the liquidity of the portfolio, ie. the ability to liquidate investments to meet the Council's cash requirements, through maintaining at least £10m in instant access accounts. At 30 June £29.0m was invested in instant access accounts. Whilst short term investments provide liquidity and reduce the risk of default, they do also leave the Council exposed to falling interest rates.

Under CIPFA's Treasury Management Code it is necessary to specify limits on the amount of long term investments, ie. Investments exceeding 364 days that have maturities beyond year end in order to ensure that sufficient money can be called back to meet the Council's cash flow requirements. The Council's performance against the limits set by the City Council on 20 March 2012 is shown below.

Maturing after	Limit	Actual
	£m	£m
31/3/2013	110	72
31/3/2014	90	10
31/3/2015	80	0

7. INTEREST RATE RISK

This is the risk that interest rates will move in a way that is adverse to the City Council's position.

The CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes require local authorities to set upper limits for fixed interest rate exposures. Fixed interest rate borrowing exposes the Council to the risk that interest rates could fall and the Council will pay more interest than it need have done. Long term fixed interest rate investments expose the Council to the risk that interest rates could rise and the Council will receive less income than it could have received. However fixed interest rate exposures do avoid the risk of budget variances caused by interest rate movements. The Council's performance against the limits set by the City Council on 20 March 2012 is shown below.

	Limit	Actual
	£m	£m
Maximum Projected Gross Borrowing – Fixed Rate	378	364
Minimum Projected Gross Investments – Fixed Rate	-	(74)
Fixed Interest Rate Exposure	378	290

The CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes also require local authorities to set upper limits for variable interest rate exposures. Variable interest rate borrowing exposes the Council to the risk that interest rates could rise and the Council's interest payments will increase. Short term and variable interest rate investments expose the Council to the risk that interest rates could fall and the Council's investment income will fall. Variable interest rate exposures carry the risk of budget variances caused by interest rate movements. The Council's performance against the limits set by the City Council on 20 March 2012 is shown below.

	Limit	Actual
	£m	£m
Minimum Projected Gross Borrowing – Variable Rate	-	-
Maximum Projected Gross Investments – Variable Rate	(378)	(180)
Variable Interest Rate Exposure	(378)	(180)

The City Council is particularly exposed to interest rate risk because all the City Council's debt is made up of fixed rate long term loans, but most of the City Council's investments are short term. Future movements in the Bank Base Rate tend to affect the return on the Council's investments, but leave fixed rate long term loan payments unchanged.

The risk of a 0.5% increase in interest rates to the Council is as follows:

<u>Effect of +/- 0.5% Rate Change</u>	2012/13 £'000	2013/14 £'000	2014/15 £'000	2015/16 £'000
Long Term Borrowing	-	2	55	55
Investment Interest	(793)	(1,072)	(998)	(908)
Net Effect of +/- 0.5% Rate Change	(793)	(1,070)	(943)	(853)

8. MATURITY STRUCTURE OF BORROWING

In recent years the cheapest loans have tended to be very long loans repayable at maturity.

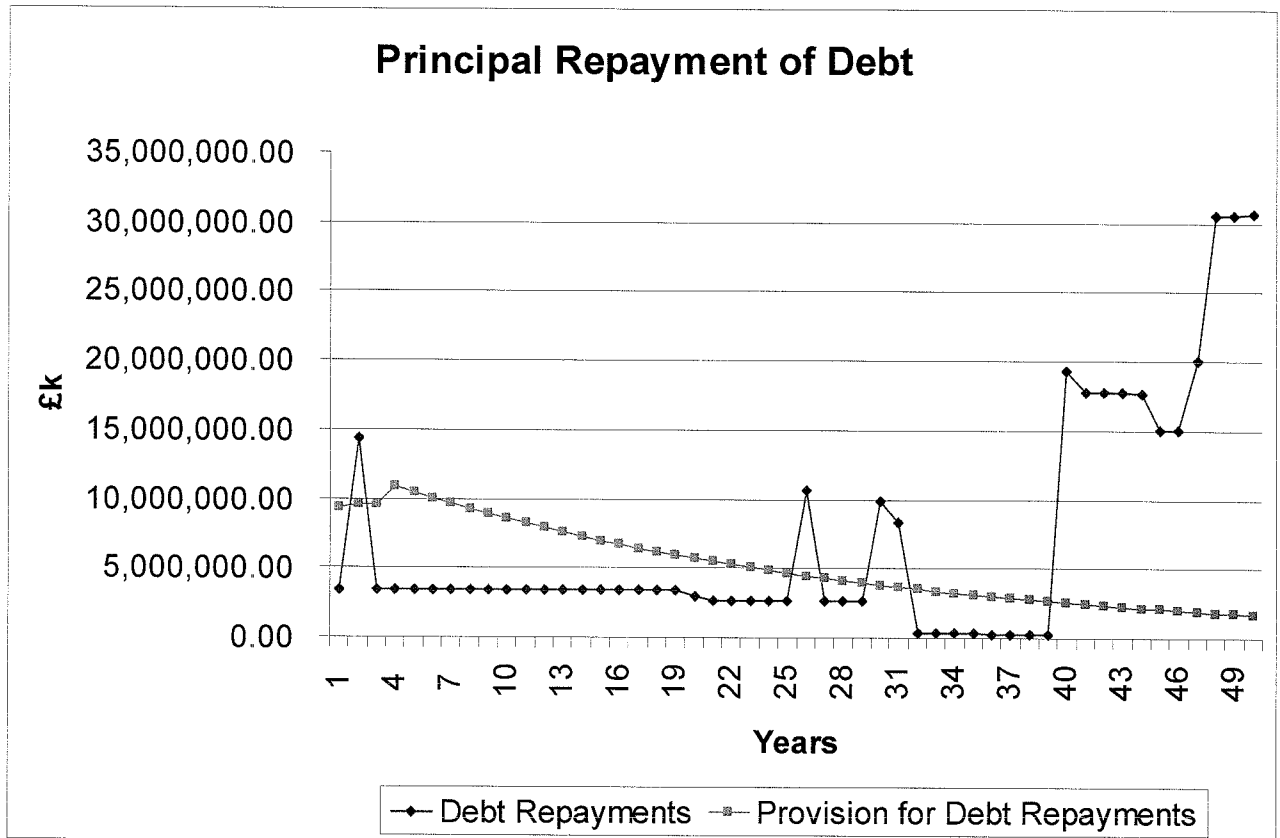
During 2007/08 the Council rescheduled £70.8m of debt. This involved repaying loans from the Public Works Loans Board (PWLB) early and taking out new loans from the PWLB with longer maturities ranging from 45 to 49 years. The effect of the debt restructuring was to reduce the annual interest payable on the Council's debt and to lengthen the maturity profile of the Council's debt.

£50m of new borrowing was taken in 2008/09 to finance capital expenditure. Funds were borrowed from the PWLB at fixed rates of between 4.45% and 4.60% for between 43 and 50 years.

A further £173m was borrowed in 2011/12 to finance capital expenditure and the HRA Self Financing payment to the Government. Funds were borrowed from the PWLB at rates of between 3.48% and 5.01%. £89m of this borrowing is repayable at maturity in excess of 48 years. The remaining £84m is repayable in equal installments of principal over periods of between 20 and 31 years.

As a result of interest rates in 2007/08 when the City Council rescheduled much of its debt and interest rates in 2008/09 and 2011/12 when the City Council undertook considerable new borrowing 58% of the City Council's debt matures in over 40 years time.

The Government has issued guidance on making provision for the repayment of debt which the Council is legally obliged to have regard to. The City Council is required to make greater provision for the repayment of debt in earlier years. Therefore the City Council is required to provide for the repayment of debt well in advance of it becoming due. This is illustrated in graph below.



This means that it is necessary to invest the funds set aside for the repayment of debt with its attendant credit and interest rate risks (see sections 5 and 7). The City Council could reschedule its debt, but unless certain market conditions exist at the time, premium payments have to be made to lenders.

CIPFA's Treasury Management in the Public Services Code of Practice which the City Council is legally obliged to have regard to requires local authorities to set upper and lower limits for the maturity structure of their borrowing. The limits set by the City Council on 20 March together with the City Councils actual debt maturity pattern are shown below.

	Under 1 Year	1 to 2 Years	3 to 5 Years	6 to 10 Years	11 to 20 Years	21 to 30 Years	31 to 40 Years	41 to 50 Years
Lower Limit	0%	0%	0%	0%	0%	0%	0%	0%
Upper Limit	6%	6%	18%	30%	60%	60%	60%	80%
Actual	1%	4%	3%	5%	9%	12%	8%	58%

9. REVENUE COSTS OF BORROWING 2012/13

The performance of the treasury management function against budget for the first three months of 2012/13 is shown below:

	Budget for 2012/13	Projected Expenditure for Year	Variance for Year
	£'000s	£'000s	£'000s
Interest Payable & Similar Charges	25,112	25,033	(79)
Interest Receivable	(2,212)	(2,279)	(67)
Repayment of Principal	11,644	11,415	(229)
Total	34,544	34,169	(375)

The favorable variance on interest payable is due to the interest on the HRA Self Financing loans being lower than anticipated.

The favorable variance on interest receivable is due to higher than anticipated cash balances and investment returns.

The favourable variance on the repayment of principal is due to the opening capital financing requirement which forms the basis of determining the provision for the repayment of debt being lower than originally estimated.

The Council also incurs costs in managing its cash flow, debt and investments. The Council's debt management expenses for the first quarter of 2012/13 were as follows.

Debt Management Costs

	£
Other Expenses	29,545
Support Service Charges	<u>20,000</u>
	<u>49,545</u>

**TREASURY
MANAGEMENT POLICY
STATEMENT, ANNUAL
MINIMUM REVENUE
PROVISION FOR DEBT
REPAYMENT STATEMENT
AND ANNUAL
INVESTMENT STRATEGY
2012/13**

**Portsmouth City Council
Head of Financial Services and Section 151 Officer
(Written by Michael Lloyd, Financial Services)**

TREASURY MANAGEMENT POLICY STATEMENT 2012/13

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1 BACKGROUND

- 1.1 This Council defines its Treasury Management activities as “the management of the organisation’s investments and cash flows, its banking, money market and capital market transactions, the effective control of the risks associated with those activities, and the pursuit of optimum performance consistent with those risks.”
- 1.2 This 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.
- 1.3 This 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 management techniques, within the context of effective risk management.
- 1.4 The City Council’s borrowing is governed by a Prudential Code which local authorities are required to have regard to under the Local Government Act 2003. The Prudential Code requires the City Council to approve an authorised limit and an operational boundary for external debt together with other prudential indicators designed to ensure that the capital investment plans are affordable, prudent and sustainable.

2 BORROWING LIMITS AND THE PRUDENTIAL CODE

i) Authorised Limit

The authorised limit for external debt is the maximum amount of debt which the authority may legally have outstanding at any time. The Authorised Limit includes headroom to enable the Council to take advantage of unexpected movements in interest rates and to accommodate any short-term debt or unusual cash movements that could arise during the year

	£m
Borrowing	422
Other Long Term Credit Liabilities	<u>86</u>
	<u>508</u>

2 BORROWING LIMITS AND THE PRUDENTIAL CODE (Continued)

ii) Operational Boundary

The Operational Boundary is based on the probable external debt during the course of the year. It is not a limit, but acts as a warning mechanism to prevent the authorised limit being breached.

	£m
Borrowing	398
Other Long Term Credit Liabilities	<u>86</u>
	<u>484</u>

iii) Other Prudential Indicators Contained in the Prudential Code

The following indicators are also included in the Prudential Code:

- Capital expenditure
- Ratio of financing costs to net revenue stream
- Capital financing requirement
- Incremental effect of capital investment decisions on council tax at band D

It is recommended that the prudential indicators contained in Appendix A be approved (**Recommendation 4.1(a)**).

The Prudential Code also requires local authorities to adopt the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. These are guides to good practice that the City Council has adopted and followed for several years.

3. GROSS AND NET DEBT

3.1 The borrowing and investment projections for the Council are as follows:

	2011/12 £'000	2012/13 £'000	2013/14 £'000	2014/15 £'000
Debt				
Borrowing at 1 April	191,073	374,045	377,862	377,406
Finance leases at 1 April	5,608	5,310	4,481	3,763
Service concession arrangements (including PFIs) at 1 April	88,055	85,444	84,182	83,335
Transferred debt administered by HCC at 1 April	16,230	15,577	14,924	14,271
Total Debt at 1 April	300,966	480,376	481,449	478,775
Maximum expected change in borrowing	182,972	3,817	(456)	(3,351)
Debt at 31 March	483,938	484,193	430,993	475,424
Investments				
Investments at 1 April	(136,242)	(220,198)	(212,140)	(193,890)
Maximum expected change in investments	(83,956)	8,058	18,250	8,477
Investments at 31 March	(220,198)	(212,140)	(193,890)	(185,413)
Estimated Net Debt	263,740	272,053	287,103	290,011

3.2 CIPFA's Treasury Management in the Public Services Code of Practice which the City Council is legally obliged to have regard to requires local authorities to set an upper limit on the amount of their gross debt less investments. It is recommended that the upper limit of gross debt less investments be set as follows (**recommendation 4.1(b)**):

2011/12	£263,740,000
2012/13	£272,053,000
2013/14	£287,103,000
2014/15	£290,011,000

3. GROSS AND NET DEBT (Continued)

3.2 The Council has a high level of investments relative to its gross debt due to having a high level of reserves and provisions, mainly built up to meet future commitments under the Private Finance Initiative schemes and future capital expenditure. In addition Councils are required to set aside a minimum revenue provision (MRP) for the repayment of debt, but it is often not economic to actually repay debt because of the premiums that would be incurred if loans are repaid early which therefore gives rise to investments pending the repayment of debt.

3.3 With the exception of one £11m loan, the interest rates on the Council's long-term borrowings are fixed for the next 26 years at an average rate of 4.3%. However the Council's current gross debt of £385m is £49m less than the 2012/13 capital financing requirement of £434m, ie. the Council's underlying need to borrow. This will necessitate further borrowing in the future exposing the Council to interest rate risk, ie. the risk that interest rates will rise. The CIPFA National Treasury Risk Study shows that the average interest rate on the Council's debt is projected to be between 4.1% and 4.7% in 2023. The average interest rate on local authorities' debt generally is projected to be between 4.3% and 5.9% in 2023.

3.4 The high level of investments increases the Council's exposure to credit risk, ie. the risk that an approved borrower defaults on the Council's investment. There is a short term risk that the rates at which the money can be invested will be less than the rates at which the loans were taken out. The level of investments will fall as capital expenditure is incurred, commitments under the PFI schemes are met and loans are repaid.

4 TREASURY MANAGEMENT POLICY STATEMENT

4.1 The prime objective of the Treasury Management function is the effective management and control of risk associated with the activities described in paragraph 1.1. The Code identifies the main Treasury Management risks, some of which may not apply to the City Council, as:

- Credit risk – ie. that the local authority is not repaid, with due interest in full, on the day repayment is due.
- Liquidity risk – ie. that cash will not be available when it is needed, or that the ineffective management of liquidity creates additional, unbudgeted costs.
- Interest rate risk – ie. that the authority fails to get good value for its cash dealings (both when borrowing and investing) and the risk that interest costs incurred are in excess of those for which the authority has budgeted.

4 TREASURY MANAGEMENT POLICY STATEMENT (Continued)

- Exchange rate risk – This is the risk that the authority enters into a contract priced in a foreign currency and the exchange rate fluctuates adversely between entering the contract and settling the contract.
- Maturity (or refinancing risk) – This relates to the authority's borrowing or capital financing activities, and is the risk that the authority is unable to repay or replace its maturing funding arrangements on appropriate terms.
- Legal risk – ie. that one or other party to an agreement will be unable to honour its legal obligations.
- Procedures (or systems) risk – ie. that a treasury process, human or otherwise, will fail and planned actions are not carried out through fraud, error or corruption.
- Market risk – This is the risk of adverse market fluctuations in the value of the principal sums of tradable investments such as Government gilts.

4.2 The approved activities of the Treasury Management operation are as follows: -

- (a) Cash flow (daily balance and longer term forecasting);
- (b) Investing surplus funds in approved investments;
- (c) Borrowing to finance cash deficits;
- (d) Funding of capital payments through borrowing, capital receipts, grants or leasing;
- (e) Management of debt (including rescheduling and ensuring an even maturity profile);
- (f) Interest rate exposure management;
- (g) Dealing procedures;
- (h) Use of external managers for temporary investment of funds.

4 TREASURY MANAGEMENT POLICY STATEMENT (Continued)

- 4.3 It is proposed that the Head of Financial Services and Section 151 Officer and officers nominated by him be given authority to lend surplus funds as necessary in accordance with the Treasury Management Policy (**Recommendation 4.1(c)**).

5 TREASURY MANAGEMENT STRATEGY FOR 2012/13

5.1 Objectives

It is estimated that the net interest and debt repayment costs for 2012/13 will amount to approximately £37.7m. The Treasury Management policy will therefore form a cornerstone of the Medium Term Resource Strategy. Specific objectives to be achieved in 2012/13 are:

(a) Borrowing

- To minimise the revenue costs of debt
- To manage the City Council's debt maturity profile to ensure that no single financial year exposes the authority to a substantial borrowing requirement when interest rates may be relatively high
- To match the City Council's debt maturity profile to the provision of funds to repay debt if this can be achieved without significant cost (see paragraph 5.9)
- To effect funding in any one year at the cheapest long term cost commensurate with future risk
- To forecast average future interest rates and borrow accordingly (i.e. short term and/or variable when rates are 'high', long term and fixed when rates are 'low').
- To monitor and review the level of variable interest rate loans in order to take greater advantage of interest rate movements
- To reschedule debt in order to take advantage of potential savings as interest rates change or to even the maturity profile.
- To maximise the use of all capital resources including Supported Capital Expenditure, usable capital receipts, grants and contributions, etc. (**recommendation 4.1(d)**).

5 TREASURY MANAGEMENT STRATEGY for 2010/11 (Continued)

5.1 Objectives (continued)

(b) Lending

- To ensure the security of lending (the maximisation of returns remains a secondary consideration) by investing in:
 - the United Kingdom Government;
 - Other local authorities in England, Scotland and Wales
 - Aaa rated money market funds;
 - British financial institutions that meet the City Council's investment criteria
 - Foreign financial institutions that meet the City Council's investment criteria within the jurisdiction of a Aaa government
- To maintain £10m in instant access accounts
- To make funds available to Council's subsidiaries
- To optimise the return on surplus funds
- To manage the Council's investment maturity profile to ensure that no single month exposes the authority to a substantial re-investment requirement when interest rates may be relatively low to the extent that this can be managed without compromising the security of lending

5.2 Interest Rates

5.2.1 Interest Rate Forecasts for 2012/13

No treasury consultants are currently employed by the City Council to advise on the borrowing strategy. However, the City Council does employ Sterling Consultancy Services to provide an economic and interest rate forecasting service and maintains daily contact with the London Money Market.

5 TREASURY MANAGEMENT STRATEGY (Continued)

5.2.2 Long Term Borrowing Interest Rates

Most City Council borrowing in the past has been through the Public Works Loans Board (PWLB). The PWLB interest rates are determined by HM Treasury and are set by reference to the rates in the secondary market for gilts; the public sector is therefore able to benefit from Government borrowing rates. However the Government introduced a 1% mark up between gilt rates and PWLB rates in October 2010 as part of the Comprehensive Spending review. Within a highly uncertain environment, the Bank of England must decide the stance of monetary policy. The consensus is that policymakers will pursue loose policy by keeping interest rates low and possibly expanding the asset purchase programme known as quantitative easing. In this light, and with a chance of a recession in 2012, short term interest rate futures suggest little chance of monetary tightening before 2014. Unlike the pessimistic stance of the market, Sterling Consultancy Services believe economic growth will be on the higher side and inflation will not fall as far below target as suggested by the Bank of England's inflation forecast. The Bank of England is also likely to tighten policy in the future ahead of economic activity growing, rather than having to make a sharper correction at a later date. This will cause both gilt yields and PWLB rates to rise. Gilt yields are likely to rise slowly as easing Euro zone concerns reduce the demand for safe havens, although continued asset purchases by the Bank of England will maintain the downward pressure in the first half of 2012. Sterling Consultancy Services estimate that 25-year PWLB rates will be 4.20% at the start of 2012/13, rising to 4.40% by the end of 2012/13 and 5.0% in the end of 2014. On this basis the estimated interest rate on any new long-term loans in 2012/13 will be between 4.20% and 4.40%.

5.2.3 Short Term Investment Interest Rates

The Bank of England's base rate is currently 0.5%. Sterling Consultancy Services expect a small rise in base rate in quarter 4 of 2012. The rate is then forecast to remain unchanged until midway through 2013 at which point it is forecast to start rising at roughly 25 basis points per quarter, rising to 2.5% by the end of 2014.

5 TREASURY MANAGEMENT STRATEGY (Continued)

5.3 Borrowing Requirements in the remainder of 2011/12 and 2012/13

The City Council's actual borrowing is £49m less than its underlying need to borrow as measured by its capital financing requirement. It is currently anticipated that this shortfall will be met through external borrowing from the Public Works Loans Board.

As part of the budget for 2012/13 it has been assumed that existing maturing debt of £2.5m in 2012/13 will not be replaced. Instead this debt will be repaid using internal funds (see paragraph 7.1(f)). It is recommended however, that the Head of Financial Services and Section 151 Officer be given delegated authority to either replace maturing debt or repay it depending on the outlook for long term interest rates that exists at the time (**Recommendation 4.1(e)**).

5.4 Volatility of Budgets

The budget for interest payments and receipts is based on both the level of cash balances available and the interest rate forecasts contained in paragraph 5.2. Any deviation of interest rates from these forecasts will give rise to budget variances.

The Council is exposed to interest rate fluctuations through the need to borrow £49m to fund its capital financing requirement, ie. underlying need to borrow in the medium term.

The Council also currently has substantial sums of cash invested in the short term, and if interest rates fall below the budget forecast, investment income will be less than that budgeted. For example, if short-term interest rates fall to 0.5% below the budget forecast, the income from the Council's investments will be £415k below budget in 2012/13. Conversely, if short-term interest rates rise to 0.5% above the budget forecast, income from the Council's investments will exceed the budget by £415k in 2012/13.

5 TREASURY MANAGEMENT STRATEGY (Continued)

5.5 Upper limits for fixed interest rate exposures

The CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes require local authorities to set upper limits for fixed interest rate exposures.

The City Council's maximum fixed interest rate exposure throughout each year is anticipated to be as follows:

	2011/12	2012/13	2013/14	2014/15
	£m	£m	£m	£m
Maximum Projected Gross Borrowing – Fixed Rate	374	378	378	377
Minimum Projected Gross Investments – Fixed Rate	(16)	-	-	-

It is recommended that the upper limits for fixed interest rate exposures be set as follows (**Recommendation 4.1(f)**):

2011/12 £358m

2012/13 £378m

2013/14 £378m

2014/15 £377m

The recommended upper limits for fixed interest rate exposure are set to provide sufficient flexibility for the Head of Financial Services and Section 151 Officer to take out fixed rate loans to finance capital expenditure if interest rates fall or are expected to rise significantly.

5 TREASURY MANAGEMENT STRATEGY (Continued)

5.6 Upper limits for variable interest rate exposures

The CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes require local authorities to set upper limits for variable interest rate exposures.

The City Council's maximum variable interest rate exposure throughout each year is anticipated to be as follows:

	2011/12	2012/13	2013/14	2014/15
	£m	£m	£m	£m
Minimum Projected Gross Borrowing – Variable Rate	-	-	-	-
Maximum Projected Gross Investments – Variable Rate	(374)	(378)	(378)	(377)

The Council's variable interest rate exposure is negative because it has no variable rate loans and a high proportion of its investments are either variable rate or will need to be reinvested within a year. The Council's requirement for cash varies considerably through the year. Therefore the Council needs to invest a proportion of its surplus cash either in instant access accounts or short term investments to avoid becoming overdrawn. The Council is exposed to an interest rate risk in that its investment income will fall if interest rates fall, whilst its borrowing costs will remain the same as all its loans are fixed at rates that will not fall with investment rates. Investment rates are currently very low and the scope for further reductions is very limited. The Council could mitigate this risk through making long term investments. However, this will increase credit risk. It would also be prudent to maintain an even maturity profile so that the Council can benefit from rising interest rates in the future

It is recommended that the upper limits for variable interest rate exposures be set as follows (**Recommendation 4.1(g)**):

2011/12	(£374m) - Investments up to £374m
2012/13	(£378m) – Investments up to £378m
2013/14	(£378m) – Investments up to £378m
2014/15	(£377m) – Investments up to £377m

5 TREASURY MANAGEMENT STRATEGY (Continued)

5.7 Limits on total principal sums invested for periods longer than 364 days

Under the Treasury Management Code it is necessary to specify limits on the amount of long term investments, ie. investments exceeding 364 days that have maturities beyond year end.

Appendix B shows the City Council's core cash which could be invested long term, ie. in excess of 364 days. Investing long term at fixed rates provides certainty of income and reduces the risk of interest rates falling. However this benefit is significantly reduced at the moment as the interest rates on new investments are low, typically less than 1% which restricts how much further returns can fall. At the current time, investing long term allows higher yields to be obtained, although it would be prudent to maintain opportunities to invest when interest rates are higher. It is recommended that the limits on sums invested for periods longer than 364 days be set on the basis of the forecast core cash so that there is flexibility to take advantage of the yield. It is recommended that the following limits be placed on total principal sums invested for periods longer than 364 days to **(Recommendation 4.1(h))**:

31/3/2012 = £129m

31/3/2013 = £110m

31/3/2014 = £90m

31/3/2015 = £80m

5.8 Limits for the maturity structure of borrowing

The Government has issued guidance on making provision for the repayment of debt (see paragraph 9) which the Council is legally obliged to have regard to. The City Council is required to make greater provision for the repayment of debt in earlier years. Therefore the City Council is required to provide for the repayment of debt well in advance of it becoming due. This is illustrated in Appendix C. This means that it is necessary to invest the funds set aside for the repayment of debt with its attendant credit and interest rate risks (see paragraph 4.1). The City Council could reschedule its debt, but unless certain market conditions exist at the time, premium payments have to be made to lenders (see paragraph 5.9).

CIPFA's Treasury Management in the Public Services Code of Practice which the City Council is legally obliged to have regard to requires local authorities to set upper and lower limits for the maturity structure of their borrowing.

It is recommended that the upper limit should be set high enough to allow for debt to be rescheduled into earlier years and for any new borrowing to mature over a shorter period than that taken out in 2007/08 and 2008/09. The high upper limit for debt maturing in 40 to 50 years time reflects existing borrowing as the upper limit cannot be set lower than the existing maturity profile. This is illustrated in Appendix C.

It is recommended that the lower limit be set at 0%.

5 TREASURY MANAGEMENT STRATEGY (Continued)

5.8 Limits for the maturity structure of borrowing (Continued)

In order to ensure a reasonably even maturity profile (paragraph 5.1(a)), it is recommended that the council set upper and lower limits for the maturity structure of its borrowings as follows (**Recommendation 4.1(i)**).

Amount of fixed rate borrowing maturing in each period as a percentage of total projected borrowing that is fixed rate.

	Upper limit	Lower limit
Under 12 months	6%	0%
12 months and within 24 months	6%	0%
24 months and within 5 years	18%	0%
5 years and within 10 years	30%	0%
10 years and within 20 years	60%	0%
20 years and within 30 years	60%	0%
30 years and within 40 years	60%	0%
40 years and within 50 years	80%	0%

The current maturity pattern contained in Appendix C is well within these limits.

5.9 Debt Rescheduling

5.9.1 At the present time, all the City Council's long term external debt has been borrowed at fixed interest rates ranging from 3.9% to 4.78%. 46% of the Council's debt matures in over 40 years time. Appendix C shows the long term loans maturity pattern. Therefore debt rescheduling could be beneficial in evening out the debt maturity profile.

5.9.2 In the event that it was decided to further reschedule debt, account will need to be taken of premium payments to the PWLB. These are payments to compensate the PWLB for any losses that they may incur.

5 TREASURY MANAGEMENT STRATEGY (Continued)

5.9 Debt Rescheduling (Continued)

- 5.9.3 The HRA will be responsible for its proportion of the premium due for early redemption of debt, based on the percentage of debt attributable to the HRA at the start of the financial year. The premiums would be charged to the General Fund and the HRA. Regulations allow the City Council to spread the cost of the premiums over a number of years, during which the accounts would benefit from reduced external interest rates.
- 5.9.4 The Head of Financial Services and Section 151 Officer will continue to monitor the Council's debt and will undertake further rescheduling if it would be beneficial.
- 5.9.5 It is recommended that authority to reschedule debt during the year be delegated to the Head of Financial Services and Section 151 Officer subject to conditions being beneficial to the City Council (**Recommendation 4.1(j)**).

6 APPROVED METHODS OF RAISING CAPITAL FINANCE

- 6.1 The following list specifies the various types of borrowing instruments which are available: -

	Variable	Fixed
PWLB	Y	Y
Market Long-term	Y	Y
Market Temporary	Y	Y
Overdraft	Y	
Negotiable Bonds	Y	
Internal (capital receipts & revenue balances)	Y	Y
Commercial Paper	Y	Y
Medium Term Notes	Y	Y
Leasing	Y	Y
Bills & Local Bonds	Y	Y

- 6.2 The main methods of raising capital finance used by the City Council are discussed in greater detail within Section 7 of this report. Other methods are not generally used because of the perceived risk or because administrative costs are high, such as in the case of Local Bonds.

6 APPROVED METHODS OF RAISING CAPITAL FINANCE (Continued)

- 6.3 Local authorities are not required to conform to the Money Laundering Regulations stipulated in the Financial Services Acts. However, these principles where practical will be applied when arranging future money market borrowing to ensure that funds are not obtained from potentially unscrupulous sources.

7 APPROVED SOURCES OF BORROWING

- 7.1 Further information on some of the main borrowing instruments used by the City Council is set out below: -

(a) Public Works Loans Board (PWLB)

The main source of longer term borrowing for the City Council for many years has been from the Government through the Public Works Loans Board. The PWLB offers fixed rate loans from 1 year to 50 years at varying rates with different methods of repayment.

Alternatively the PWLB offers variable rate loans for 1 to 10 years, where the interest rate varies at 1, 3 or 6 month intervals. These loans can be replaced by fixed rate loans before maturity at an opportune time to the authority.

(b) Money Market Loans – Long Term

Loans for 1 to 70 years are available through the London Money Market although, depending of the type of loan being arranged, the rates of interest offered may not match those available from the PWLB, especially for Equal Instalment of Principal loans (E.I.P. loans). Any loans to be taken are evaluated to ensure that the interest rate is the lowest the City Council could obtain.

Loans offered by the money market are often LOBO (Lenders Option, Borrowers Option) loans. This enables the authority to take advantage of low fixed interest for a number of years before an agreed variable rate comes into force. At the time when the interest rate becomes variable, the lender has the option to increase the rate charged every 6 months (or any other agreed review period). The borrower has the option to repay the loan with no penalties if the interest rate is increased on any of the review dates.

7 APPROVED SOURCES OF BORROWING (Continued)

(c) Bonds

Bonds may be suitable for raising sums in excess of around £150m. The interest payable on bonds may be less than that charged by the PWLB, but considerable upfront fees would be incurred. To obtain the best interest rate, the Council would need to obtain a credit rating which would need to be maintained. This would incur a further upfront fee and an annual maintenance fee.

Because such a large amount needs to be borrowed to attract investors and also to reduce the upfront fees and negate the need for an individual credit rating a pooled issuance with other local authorities may be more viable.

(d) Money Market Loans – Temporary (Loans up to 364 days)

The use of temporary borrowing through the London Money Market forms an important part of the strategy. The authorised limit for external debt in 2012/13 of £458m set by the City Council on 14 February 2012 must not be exceeded. It is anticipated that the City Council will not need to use the temporary borrowing facility in 2012/13.

(e) Overdraft

An overdraft limit of £2m has been agreed with the Co-operative Bank plc. Interest on the overdraft is charged at 1% above base rate. The City Council does not anticipate that short-term borrowing will generally be necessary during 2012/13 as it currently holds sufficient funds to enable the authority's cash flow to be managed without the need to borrow. However, the overdraft facility may be used when there are unforeseen payments and funds placed on temporary deposit cannot be called back in time.

(f) Internal Funds

Internal funds include all revenue reserves and other specific reserves maintained by the City Council, including the minimum revenue provision which is available to either repay debt or to be used instead of new borrowing. The cash held in internal funds such as earmarked reserves can be borrowed in the short term to fund capital expenditure or the repayment of debt, thus delaying the need to borrow externally.

- 7.2 It is recommended that no restriction be placed on the amount that can be borrowed in sterling from an individual lender provided it is from a reputable source and within the authorised limit for external debt approved by the City Council (**Recommendation 4.1(k)**).

8. APPORTIONMENT OF BORROWING COSTS TO THE HOUSING REVENUE ACCOUNT (HRA)

8.1 The Localism Act 2011 will require local authorities to allocate existing and future borrowing costs between council housing (the HRA) and the General Fund as the current statutory method of apportioning debt charges between the General Fund and the HRA will cease. The Government has signalled its intention not to impose a single solution and it is for local authorities to choose an allocation method that achieves the principals detailed in their treasury management strategies.

8.2 It is proposed to continue with a single loans pool and apportion costs according to locally established principals. It is recommended that the principals upon which the apportionment of borrowing costs should be based are as follows (**recommendation 4.1(I)**):

- The apportionment is broadly equitable between the HRA and the General Fund, and is detrimental to neither;
- The loans portfolio is managed in the best interests of the whole authority;
- The benefits of uninvested balance sheet resources which allow borrowing to be below the capital financing requirement (CFR) are equitably shared between the General Fund and the HRA.

8.3 For the purpose of apportioning borrowing costs it will be assumed that the HRA is under or over financed in the same proportion as the Council as a whole. The HRA will be charged interest at the Council's average cost of borrowing adjusted to take account of any under or over financing which will be charged at the average return on the Council's investments.

9 ANNUAL MINIMUM REVENUE PROVISION FOR DEBT REPAYMENT STATEMENT

- 9.1 The Local Authorities (Capital Finance and Accounting) (Amendment) Regulations 2012 require the Council to make “prudent provision” for the repayment of General Fund debt from 2008/09 onwards. There is no requirement to make “prudent provision” for the repayment of Housing Revenue Account (Council Housing) debt. The Government has provided a definition of “prudent provision” which the Council is legally obliged to “have regard” to. The guidance aims to ensure that the provision for the repayment of borrowing which financed the acquisition of an asset should be made over a period bearing some relation to that over which the asset continues to provide a service.
- 9.2 The guidance also requires the Council to adopt an Annual Minimum Revenue Provision (MRP) for Debt Repayment Statement. This is contained within paragraphs 10, 11, 12 and 13 below.

10 GOVERNMENT- SUPPORTED BORROWING OTHER THAN FINANCE LEASES AND SERVICE CONCESSIONS INCLUDING PRIVATE FINANCE INITIATIVE SCHEMES

- 10.1 The Government has supported some local authority borrowing through the Formula Grant. Provision may be made for the repayment of existing and new government supported borrowing through the Capital Financing Requirement Method or the Regulatory Method.
- 10.2 For debt that is supported by Formula Grant, authorities are able to make revenue provision for the repayment by setting aside 4% of their Adjusted Non-Housing Capital Financing Requirement (CFR). The CFR represents the underlying requirement to borrow for capital expenditure. It takes the total value of the City Council's fixed assets and determines the amount that has yet to be repaid or provided for within the Council's accounts. The CFR is adjusted so that it excludes self-financed debt incurred after 1 April 2008. This is known as the CFR Method.
- 10.3 Alternatively, for debt that is supported by Formula Grant, authorities are able to continue to use the formulae in the previous regulations, since Formula Grant is calculated on that basis. This is known as the Regulatory Method. This method is also based on the CFR but is adjusted by the effect of the previous regulations. This method is more complex than the CFR method. However it is estimated that the MRP under this method will be £320k less per annum than under the CFR method. It is therefore recommended that the Regulatory Method of calculating MRP be applied to pre 1 April 2008 debt and new government supported debt (**Recommendation 4.1(m)**). This is the same method as that adopted for 2011/12.

11. SELF-FINANCED BORROWING OTHER THAN FINANCE LEASES AND SERVICE CONCESSIONS INCLUDING PRIVATE FINANCE INITIATIVE SCHEMES

- 11.1 For new borrowing under the prudential system for which no Government support is being given and is therefore self-financed, there are three options offered by the guidance, the Asset Life (Equal Instalment) Method, the Asset Life (Annuity) Method and the Depreciation Method. The guidance suggests that the Asset Life (Annuity) Method is only appropriate for projects where income or savings will increase over time. Both the Asset Life (Equal Instalment) Method and the Depreciation Method should result in a similar MRP. Of these two methods the Asset Life method is the simplest to calculate and therefore it is recommended that this method be used and that MRP begin to be made in the year after the asset is completed (**Recommendation 4.1(n)**). This is the same method as that adopted for 2011/12.

12. FINANCE LEASES AND ON BALANCE SHEET SERVICE CONCESSIONS INCLUDING PRIVATE FINANCE INITIATIVE SCHEMES

- 12.1 The move to International Financial Reporting Standards has involved arrangements under the Private Finance Initiative (PFI) and service concessions coming onto the balance sheet. A part of the service charge or rent payable will be taken to reduce the balance sheet liability rather than being charged to the service revenue account. This accounting treatment is similar to that for finance leases. Under these leases the risks and rewards of asset ownership rest with the City Council and the assets are shown on the City Council's balance sheet. These leases are therefore in effect a form of borrowing. Statutory guidance allows, in the case of finance leases and on balance sheet service concessions including PFI contracts, the MRP requirement to be regarded as met by a charge equal to the element of the rent / charge that goes to write down the balance sheet liability. It is recommended that this methodology be used to calculate the MRP on finance leases and service concessions including PFI arrangements (**Recommendation 4.1(o)**).

13 HOUSING REVENUE ACCOUNT (HRA) BORROWING

- 13.1 There is no statutory requirement for the HRA to provide for the repayment of its debt. On 28 March 2012 the HRA will be required to make a self financing payment to the Government of £88.619m. It is recommended that the HRA provide for the repayment of this debt over 30 years in line with the HRA Business Plan (**recommendation 1(p)**). The HRA will continue its practice of not providing for its other debts.

14 ANNUAL INVESTMENT STRATEGY

- 14.1 The Government has also issued guidance on investments. The guidance requires the City Council to adopt an Annual Investment Strategy. This is contained within paragraphs 15, to 21 below. The requirements of the Department for Communities and Local Government are in addition to the requirements of the Chartered Institute of Public Finance and Accountancy's Treasury Management in Public Services: Code of Practice.
- 14.2 During the year the Council may be asked to approve a revised strategy if there are investment issues which the full Council might wish to have brought to their attention.
- 14.3 The guidance defines a prudent policy as having two objectives:
- achieving first of all security (protecting the capital sum from loss);
 - liquidity (keeping the money readily available for expenditure when needed).
- Only when proper levels of security and liquidity have been secured should yield be taken into account.
- 14.4 Investment strategies usually rely on credit ratings and both the current and recommended Investment Strategies are based on credit ratings. Although the recommended Investment Strategy is based on credit ratings other sources of information will be taken into account prior to placing deposits such as information in the quality financial press and credit default swaps (CDS) prices.
- 14.5 CDS are a financial instrument for swapping the risk of debt default. The buyer of a credit default swap pays a premium for effectively insuring against a debt default. He receives a lump sum payment if the debt instrument is defaulted. The seller of a credit default swap receives monthly payments from the buyer. If the debt instrument defaults they have to pay an agreed amount to the buyer of the credit default swap. Absolute prices can be unreliable; however trends in CDS spreads do give an indicator of relative confidence about credit risk.

15. INVESTMENT CONSULTANTS

15.1 The City Council currently employs consultants to provide the following information:

- Interest rate forecasts
- Credit ratings
- CDS prices

15.2 The City Council does not employ consultants to provide strategic advice.

15.3 Forecasts prepared by consultants will be compared periodically with actual interest rates.

16. SPECIFIED INVESTMENTS

16.1 The Government requires the Council to identify investments offering high security and high liquidity. These are known as specified investments. Specified investments will be made with the minimum of procedural formalities. They must be made in sterling with a maturity of no more than one year and must not involve the acquisition of share capital or loan capital in any corporate body.

16.2 Credit rating information is available to the financial market through three main credit rating bodies ie. Moody's, Fitch, and Standard and Poor. The credit ratings provided are as follows:

- Short Term Rating (measures an institution's suitability for short term investment)
- Long Term Rating (measures an institution's suitability for long term investment). These ratings are explained in Appendix D.
- Viability / Financial Strength Rating (measures the likelihood that an organisation will require assistance from third parties such as its owners or official institutions)
- Support Rating (where available measures a potential supporter's (either a sovereign state's or an individual owner's) propensity to support a bank and its ability to support it)

16. SPECIFIED INVESTMENTS (Continued)

16.3 The grades of short and long term credit rating are as follows with the best credit ratings at the top. The credit ratings that meet the City Council's investment criteria are shaded.

Fitch		Moody's		Standard & Poor's	
Short Term	Long Term	Short Term	Long Term	Short Term	Long Term
F1+	AAA	P-1	Aaa	A-1+	AAA
	AA+		Aa1		AA+
	AA		Aa2		AA
	AA-		Aa3		AA-
F1	A+		A1	A-1	A+
	A	P-2	A2		A
	A-		A3	A-2	A-
F2	BBB+	P-3	Baa1	A3	BBB+
	BBB		Baa2		BBB
F3	BBB-		Baa3		BBB-

Support ratings are graded 1 to 5, with 1 being the highest rating.

16.4 It is recommended that deposits should only be placed with institutions that have credit ratings from at least two rating agencies and have the following credit ratings:

Short Term Rating

F1 (or equivalent) from Fitch, Moody's (P-1) or Standard & Poor (A-1)

Long Term Rating

A- (single A category) or equivalent from Fitch, Moody's or Standard & Poor

Viability / Financial Strength Rating

bbb from Fitch or C- Moody's (Standard and Poor do not provide these ratings)

Support Rating

1 from Fitch

16. SPECIFIED INVESTMENTS (Continued)

- 16.5 In addition to rating financial institutions the rating agencies also rate governments. These are known as sovereign credit ratings. Sovereign credit ratings give an indication of a government's capacity to support its financial institutions. Sovereign credit ratings are also dependent on a government's ability to raise taxes and thus also give an indication of the state of a nation's general economy. It is recommended that investments should only be placed with institutions based in either the United Kingdom or states with an AAA credit rating, as reflected in Appendix E.
- 16.6 When an institution or state has differing ratings from different agencies, the average rating will be used to assess its suitability. Where an average credit rating cannot be determined the lower credit rating will be applied. Those institutions that have not been rated by a particular agency will not be discarded because of the lack of ratings.
- 16.7 It is proposed to divide the approved counter parties for specified investments into five categories with the following investment limit applied to each category. The institutions in each category are shown in Appendix E.

Category 1 – Unlimited deposits for up to 1,830 days

United Kingdom Government including the Debt Management Office Deposit Facility

Category 2 - £20m for up to 1,830 days

All local authorities in England, Scotland and Wales

Category 3 - £20m for up to 732 days

Short Term - F1+ (or equivalent from Moody's and Standard & Poor)
Long Term - AA- or better (or equivalent from Moody's and Standard & Poor)
Support - 1

Category 4 - £15m for up to 366 days

Short Term - F1 (or equivalent from Moody's and Standard & Poor)
Long Term - A+ or better (or equivalent from Moody's and Standard & Poor)
Support - 1

Category 5 - £10m for up to 366 days

Short Term - F1 (or equivalent from Moody's and Standard & Poor)
Long Term - A- or better (or equivalent from Moody's and Standard & Poor)
Support - 1

16. SPECIFIED INVESTMENTS (Continued)

- 16.8 It is proposed that the bodies detailed under categories 1 to 5 in Appendix E be approved as repositories of specified investments of the City Council's surplus funds (**Recommendation 4.1(q)**).
- 16.9 It is recommended that the credit ratings be reviewed monthly and that any institution whose average credit rating falls below the minimum level stated in paragraphs 16.4 and 16.5 be removed from the list of specified investments (**Recommendation 4.1(r)**).
- 16.10 It is recommended that institutions in category 3 that are placed on negative watch or negative outlook by the credit rating agencies be reassigned to category 4 if a subsequent down-grading means that they no longer meet the category 3 criteria (**Recommendation 4.1(s)**).
- 16.11 It is recommended that institutions in category 4 that are placed on negative watch or negative outlook by the credit rating agencies be reassigned to category 5 if a subsequent down-grading means that they no longer meet the category 4 criteria (**Recommendation 4.1(t)**).
- 16.12 It is recommended that institutions in category 5 that are placed on negative watch or negative outlook by the credit rating agencies be removed from the list of specified investments if a subsequent down-grading means that they no longer meet the category 5 criteria (**Recommendation 4.1(u)**).
- 16.13 It is recommended that the Head of Financial Services and Section 151 Officer be given delegated authority to add counter parties that meet the City Council's approved investment criteria to the list of specified investments (**Recommendation 4.1(v)**).

17. NON-SPECIFIED INVESTMENTS

- 17.1 The Government's Guidance requires that the general types of investment be identified and that a limit be set on the overall amount that may be held in such investments at any time in the year. Non-specified investments are investments that are not secure, ie. do not have an "A" credit rating or are not liquid, ie. have a maturity in excess of 364 days. Investments that are not denominated in sterling would also be non-specified investments due to exchange rate risks.
- 17.2 70% of the Council's investments are currently placed with local authorities due to the absence of a sufficient number of counter parties. Whilst other local authorities offer security, they only offer a modest return. It is estimated that the average amount of cash invested in 2012/13 will be £192m. In order to reduce the risks associated with placing funds with a relatively small number of counter parties and to improve returns it is recommended that a further investment category be established for non-specified investments that do not meet the criteria for specified investments.

Category 6 - £6m for 366 days

Short Term – F2 (or equivalent from Moody's and Standard & Poor)

Long Term – BBB or better (or equivalent from Moody's and Standard and Poor)

Support – 5

Category 6 will consist of Lloyds TSB and rated building societies that meet the above criteria.

Lloyds TSB does not meet the criteria for specified investments as it has a Bank Financial Strength Rating (BFSR) of C- on negative watch. Lloyds TSB Bank's BFSR reflects Moody's concerns about changes and "upheaval" to the bank's senior management team. The relatively new Chief Executive Officer, Antonio Horta-Osorio, had started temporary leave due to stress and the Chief Financial Officer had announced his resignation. Moody's believes the group faces "a major challenge in ensuring continuity of leadership" and stressed that these difficulties were taking place during a time of financial market volatility and amid the execution of important strategic decisions including the sale of branches.

The building societies included in category 6 do not have sufficient systemic importance to make a Government rescue likely if they get into financial difficulties. However building societies do not typically have exposure to the Euro zone or riskier investment banking activities. In addition there is an established tradition of intra sector support and when building societies have got into financial difficulties they have always been taken over by another building society.

17. NON-SPECIFIED INVESTMENTS (Continued)

17.3 The Co-operative Bank has merged with the Britannia Building Society. The Britannia Building Society was a financially weaker institution. The Co-operative Bank is also in the process of acquiring some branches of Lloyds TSB. These factors have resulted in Fitch placing the Co-operative Bank's short term rating of F2 on negative watch. The Council's investment criteria for category 6 investments is for a short term credit rating by Fitch of at least F2. The Co-operative Bank offers very competitive interest rates on investments which are out of line with the market. Whilst this does not mean that the Co-operative Bank is in financial difficulties, Northern Rock, the Icelandic banks and the Irish banks all offered interest rates on deposits that were much higher than the rest of the market. The Co-operative Bank is the Council's main bank. If funds are received too late in the day to invest with another bank they will be invested with the Co-operative Bank overnight and re-invested with another counter party the following day. The Co-operative Bank also holds the Council's Euro bank account that may be used for hedging against exchange rate risks when the Council enters into contracts denominated in foreign currencies. The Council's Euro account at the Co-operative Bank is an instant access account. Therefore it is recommended that a further investment category be created.

Category 7 - £5m overnight or instant access

Short Term – F3 (or equivalent from Moody's and Standard & Poor)

Long Term – BBB or better (or equivalent from Moody's and Standard and Poor)

Support – 3

17.4 The Council's treasury management operation is exposed to the Council's subsidiary company MMD (Shipping Services) Ltd in two ways. Firstly the Council has £550k lodged with Lloyds TSB to guarantee MMD's banking limits. The Council also lends MMD its insurance premium of £300k.

17.5 The Annual Investment Strategy provides for the Council to lend to the United Kingdom Government and local authorities in England, Scotland and Wales for five years, and AA rated banks for two years. The Annual Investment Strategy also provides for all other investments except for category 7 to have a term of up to 366 days. Financial institutions may prefer 366 day investments as they are beneficial to them in meeting financial regulations and this may provide a means of increasing investment returns without significantly increasing credit and liquidity risk. However as these investments would be just over a year they cannot be included as specified investments.

17. NON-SPECIFIED INVESTMENTS (Continued)

- 17.6 The Council sometimes enters into contracts denominated in foreign currencies. Such contracts normally relate to civil engineering schemes at the port. It can be beneficial to buy Euros early to fund these projects and avoid the associated currency risk.
- 17.7 It is recommended that non-specified investments should be limited to the following (**Recommendation 4.1 (w)**):

	£
Financial institutions that are domiciled in the UK & have very limited exposure to the Euro zone periphery & investment banking	29m
Investments in MMD (Shipping Services) Ltd including funds lodged to guarantee the company's banking limits. MMD is a wholly owned subsidiary of the City Council.	2m
Long term investments	110m
Investments in foreign currencies to hedge against contracts priced or indexed against foreign currencies	5m
Total	146m

18. MAXIMUM LEVEL OF INVESTMENT IN INDIVIDUAL ORGANISATIONS

18.1 The Government's Guidance does not require a limit to be placed on the amount that can be placed in any one investment. However in order to minimise risk further, it is proposed that the total amount that can be directly invested with any organisation at any time should be limited as follows (**Recommendation 4.1(x)**):

	Maximum Investment in Single Organisation
Category 1	Unlimited for up to 1,830 days
Category 2	£20m for up to 1,830 days
Category 3	£20m for up to 732 days
Category 4	£15m for up to 366 days
Category 5	£10m for up to 366 days
Category 6	£6m for up to 366 days
Category 7	£5m overnight or instant access
MMD (Shipping Services) Ltd including sums lodged to guarantee the company's banking limits	£2m for up to 366 days

18.2 It is recommended that the Head of Financial Services and Section 151 Officer be given delegated authority to revise the total amount that can be directly invested with any organisation at any time (**Recommendation 4.1(y)**).

18. MAXIMUM LEVEL OF INVESTMENT IN INDIVIDUAL ORGANISATIONS (Continued)

18.3 AAA money market funds offer security and same day access. By aggregating investments they can also invest in financial institutions that may not be interested in the relatively small sums that the Council can invest. All the money market funds on the list of specified investments are managed by major banks with considerable investment expertise. There are seven AAA money market funds on the Council's list of approved investments. Although AAA money market funds are well diversified in their investments there is a risk that more than one fund could have investments with the same bank or that the Council may also have invested funds in the same bank as a money market fund. Therefore it is proposed that the Council should aim to have no more than £70m invested in money market funds with an absolute limit of £80m.

18.4 Most building society lending is secured against residential properties. If property prices fall there may be inadequate security to support a building societies lending giving rise to a systemic risk.

18.5 In order to minimise systemic credit risk in any sector it is recommended that the following limits be applied (**Recommendation 4.1(z)**):

Money market funds	£80m
Building societies	£28m

18.4 In order to minimise systemic credit risk in any region it is recommended that the following limits be applied (**Recommendation 4.1(aa)**):

Asia & Australia	£40m
Americas	£40m
Continental Europe	£25m

18. MAXIMUM LEVEL OF INVESTMENT IN INDIVIDUAL ORGANISATIONS (Continued)

18.6 The limits above only apply to direct investments. The City Council's exposure to any institution, sector or region may exceed the limits stated above through indirect investments via money market funds. Money market funds employ specialist staff to assess counter party risks and all investments made by money market funds are short-term.

19. LIQUIDITY OF INVESTMENTS

19.1 The City Council maintains a three year cash flow forecast which is updated daily (See Appendix B). This forecast is used to determine the maximum period for which funds may be prudently committed, ie. the City Council's core cash. This forecast has been used to set the limits on total principal sums invested for periods longer than 364 days (see paragraph 5.7). The City Council maintains at least £10m invested on an instant access basis to ensure that unforeseen cash flows can be financed.

20. INVESTMENT OF MONEY BORROWED IN ADVANCE OF NEED

20.1 Section 12 of the Local Government Act gives a local authority the power to invest for "any purpose relevant to its functions under any enactment or for the prudent management of its financial affairs". While the speculative procedure of borrowing purely to invest at a profit is clearly unlawful, there is no legal obstacle to the temporary investment of funds borrowed for the purpose of funding capital expenditure incurred in the reasonably near future.

20.2 Some of the rental income relating to council housing is currently paid to the Government in the form of negative HRA subsidy. The Localism Act includes measures to repeal the existing Housing Revenue Account (HRA) subsidy system and replace it with powers for the Secretary of State for Communities and Local Government to introduce self-financing. This will be achieved via a reallocation of housing debt on 1st April 2012, after which councils will retain all the rental income they collect. The Council will be required to pay the Government £88.6m on 28th March 2012.

20. INVESTMENT OF MONEY BORROWED IN ADVANCE OF NEED (Continued)

- 20.3 Lower interest rate expectations and continuing concerns over the Euro zone sovereign debt caused a reduction in gilt yields and PWLB rates in April. With the expected direction of future gilt yields being upwards at that time, consideration was given to borrowing part of the Housing Revenue Account (HRA) Self Financing payment to the Government. With this in mind two loans were taken from the PWLB. The first loan was for £20m for 31 years at 5.01%. The second loan was for £14m for 20 years at 4.52%. Both loans are repayable through equal instalments of principal.
- 20.4 Risk averse attitudes in the financial markets caused a further reduction in gilt yields and PWLB rates in August. With the expected direction of future gilt yields being upwards consideration was given to borrowing more of the Housing Revenue Account (HRA) Self Financing payment to the Government. With this in mind two further loans were taken from the PWLB. The first loan was taken on 16 August for £25m for 30 years at 4.44%. The second loan was taken on 23 August for £25m for 30 years at 4.19%. Both loans are repayable through equal instalments of principal. All but £4.6m of the City Council's HRA Self Financing payment is now fully funded.
- 20.5 On 29 September the Chief Secretary to the Treasury announced that local authorities would be allowed to borrow from the Public Works Loans Board (PWLB) at National Loans Fund (NLF) rates to fund the HRA Self Financing payment. NLF rates are typically 1.13% below the rates the PWLB normally offers to local authorities. The PWLB will make NLF rates available to local authorities on 26 March 2012 for the purposes of funding HRA Self Financing payments. Despite local authorities being given indicative HRA Self Financing payment figures before the start of this financial year, there was no indication that the PWLB would offer loans at NLF rates prior to 29 September. The only way that the Council can now benefit from these interest rates would be to borrow in advance of need.
- 20.6 It is therefore recommended that the Head of Financial Services and Section 151 Officer be given delegated authority to borrow up to £50m in advance of need as measured by the Capital Financing Requirement (**recommendation (ab)**). This is the estimated borrowing required to support the Council's capital programme until 2016/17.
- 20.7 Borrowing in advance of need may enable the City Council to obtain cheaper loans than those available at the time when expenditure is incurred, although the consequent investment of funds borrowed in advance of need does expose the City Council to credit risk. The interest payable on funds borrowed in advance of need is likely to

exceed the interest earned on the investment of those funds in the current economic climate.

21. TRAINING OF INVESTMENT STAFF

- 21.1 The Finance Manager (Technical & Financial Planning) manages the treasury function with assistance from the Senior Financial Planning Accountant. Both these officers are qualified Chartered Public Finance Accountants. In addition the Finance Manager (Technical & Financial Planning) holds the Association of Corporate Treasurers Certificate in International Treasury Management. The City Council is also a member of CIPFA's Treasury Management Forum which provides training events throughout the year. Additional training for investment staff is provided as required.

22. DELEGATED POWERS

- 22.1 Once the Treasury Policy has been approved, the Head of Financial Services and Section 151 Officer has delegated powers under the Standing Orders of the City Council, to make all executive decisions on borrowing, investments or financing in accordance with CIPFA's 'Code for Treasury Management in the Public Services'.

23. TREASURY SYSTEMS AND DOCUMENTATION

- 23.1 Once the Policy Statement has been approved by the Council, the documentation of the Treasury Systems will be updated so that all employees involved in Treasury Management are clear on the procedures to be followed and the limits applied to their particular activities.

23. TREASURY SYSTEMS AND DOCUMENTATION (CONTINUED)

23.2 The Treasury Management Practices document covers the following topics: -

- risk management
- best value and performance measurement
- decision making and analysis
- approved instruments, methods and techniques
- organisation, clarity and segregation of responsibilities, and dealing arrangements
- reporting requirements and management information arrangements
- budgeting, accounting and audit arrangements
- cash and cash flow management
- money laundering
- staff training and qualifications
- use of external service providers
- corporate governance

24. REVIEW AND REPORTING ARRANGEMENTS

24.1 The Head of Financial Services and Section 151 Officer will submit the following:-

- (i) an annual report on the treasury management outturn to the Council by 30 September of the succeeding financial year
- (ii) a mid year review to the Council
- (iii) the Annual Strategy Report to the Council in March 2013
- (iv) quarterly treasury management monitoring reports to the Cabinet and the Governance and Audit Committee

PRUDENTIAL INDICATORS

Capital Expenditure						
	2010/11 Actual £000	2011/12 Estimate £000	2012/13 Estimate £000	2013/14 Estimate £000	2014/15 Estimate £000	2015/16 Estimate £000
Culture & Leisure	1,959	2,617	3,645	478	300	100
Childrens Services	2,522	17,832	15,491	7,007	7,000	7,599
Education	11,527	98	184	-	-	-
Environment & Community Safety	802	3,601	1,821	633	22,000	22,000
Health & Social Care (Adults Services)	6,469	2,122	790	3,160	2,605	525
Resources	4,635	7,180	8,205	264	-	-
Millennium	3	112	917	90	-	-
Planning, Regeneration & Economic Development	48	615	2,286	1,000	2,000	6,000
Commercial Port	11,578	4,278	4,799	170	-	-
Traffic & transportation	8,475	7,285	24,195	21,316	8,909	3,875
Licensing Committee	5	10	-	-	-	-
Housing General Fund	4,989	3,942	2,604	3,601	3,161	3,161
Non HRA	53,012	49,692	64,937	37,719	45,975	43,260
HRA	15,163	113,159	26,108	32,714	26,447	27,025
Total	68,175	162,851	91,045	70,433	72,422	70,285

Ratio of financing costs to net revenue stream						
	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Non - HRA	12.4%	12.1%	11.8%	12.0%	11.2%	11.4%
HRA	2.9%	12.9%	12.0%	11.2%	10.2%	9.7%

Capital Financing Requirement						
	2010/11 Actual £000	2011/12 Estimate £000	2012/13 Estimate £000	2013/14 Estimate £000	2014/15 Estimate £000	2015/16 Estimate £000
Non - HRA	281,152	286,738	290,269	287,722	287,056	286,209
HRA	55,385	147,200	143,924	143,271	139,996	136,721

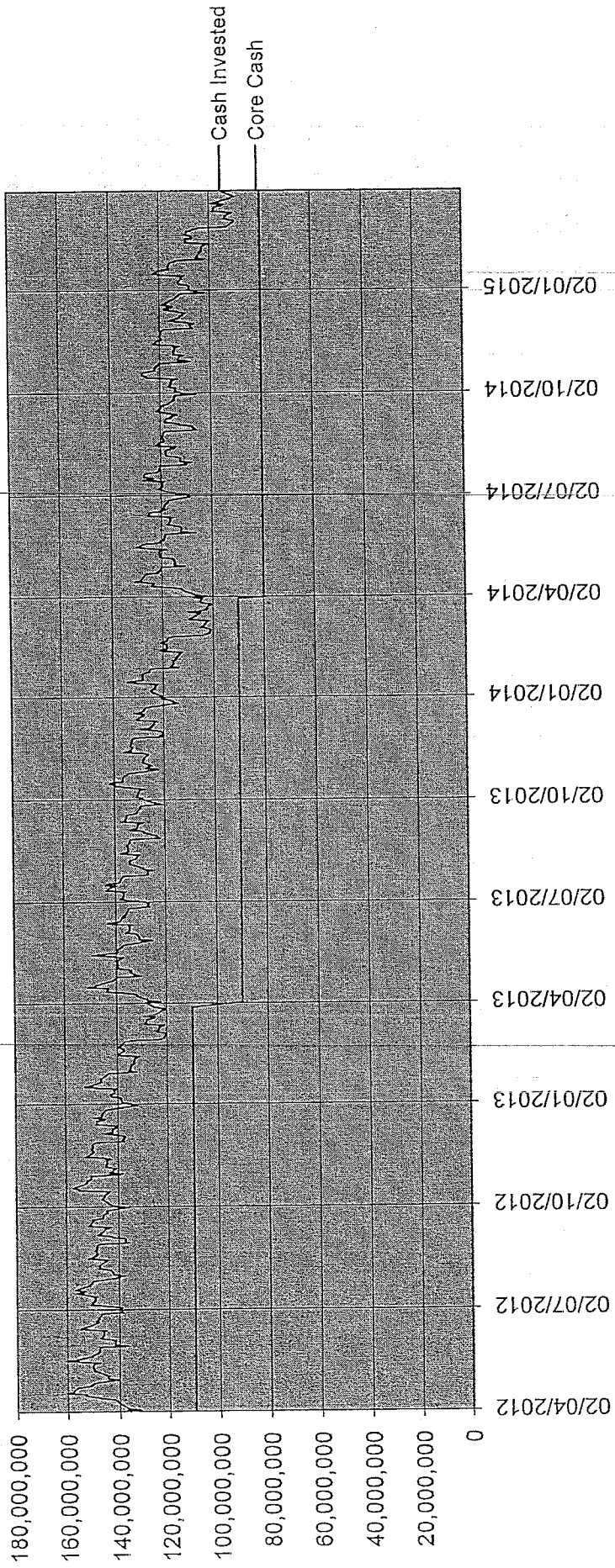
Authorised Limit for External debt						
	2010/11 Actual £000	2011/12 Estimate £000	2012/13 Estimate £000	2013/14 Estimate £000	2014/15 Estimate £000	2015/16 Estimate £000
Borrowing	296,055	418,854	421,661	420,497	418,083	416,150
Other Long Term Liabilities (ie Credit Arrangements)	102,160	88,144	86,053	84,488	83,441	81,740
Total	398,215	506,998	507,714	504,985	501,524	497,890

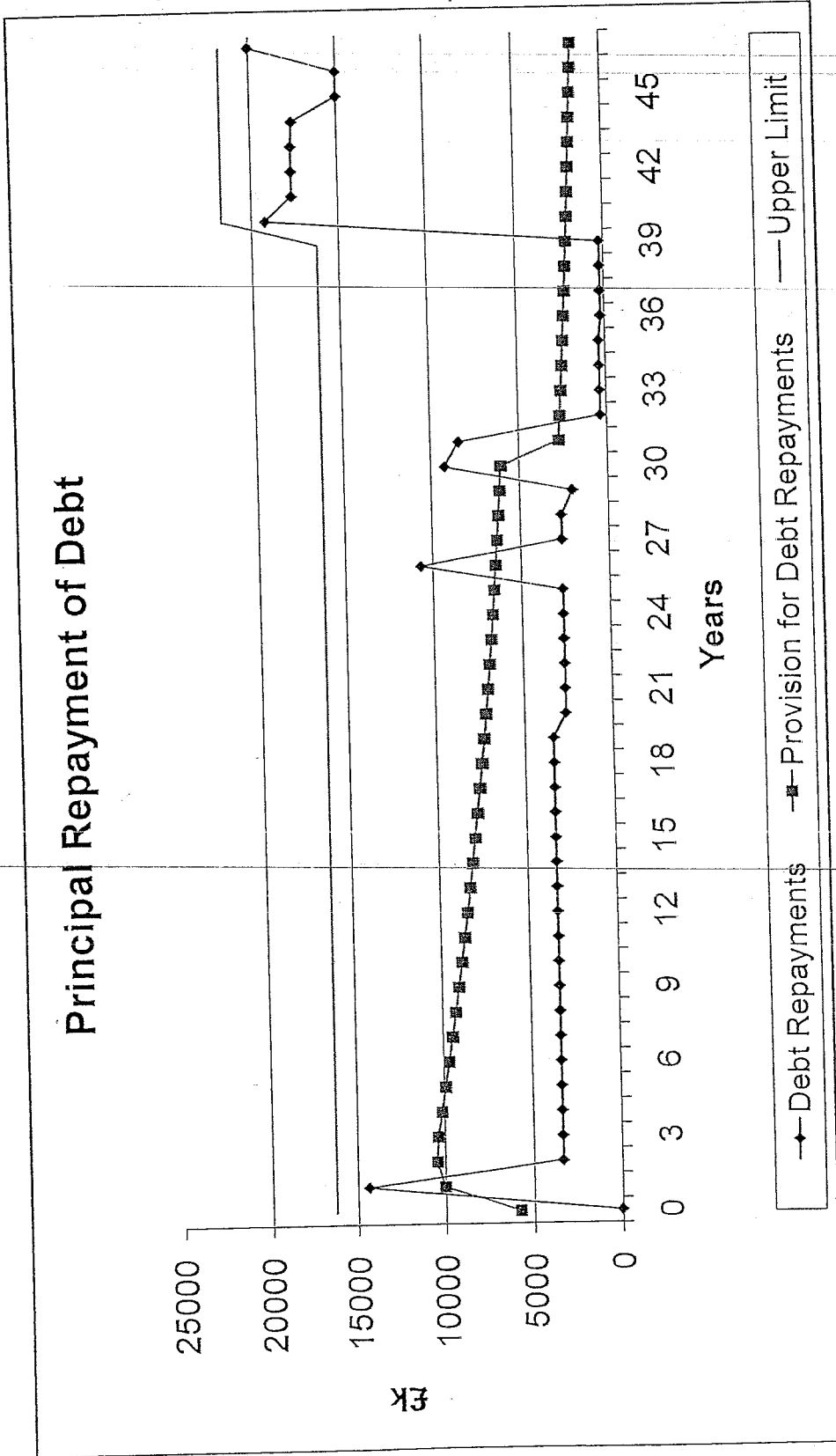
Operational boundary for external debt						
	2010/11 Actual £000	2011/12 Estimate £000	2012/13 Estimate £000	2013/14 Estimate £000	2014/15 Estimate £000	2015/16 Estimate £000
Borrowing	282,535	395,794	398,140	396,506	393,611	391,189
Other Long Term Liabilities (ie Credit Arrangements)	102,160	88,144	86,053	84,488	83,441	81,740
Total	384,695	483,938	484,193	480,994	477,052	472,929

	2012/13 Estimate £000	2013/14 Estimate £000	2014/15 Estimate £000	2015/16 Estimate £000
Revenue effect of existing capital programme	1,369	2,586	2,993	3,278
Revenue effect of proposed capital programme	1,429	2,806	3,362	3,003
Increase in revenue effect	60	220	369	(275)
Increase in Council Tax Band D	£1.00	£3.68	£6.16	(£4.59)

APPENDIX B

Forecast Cash Invested





DEFINITIONS OF LONG TERM CREDIT RATINGS

Credit ratings are issued by three main credit rating agencies, Fitch, Moody's and Standard & Poor. All three agencies use broadly the same scale. Fitch defines its long term ratings as follows:

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.

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.

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 in the case of the higher ratings.

BBB: Good credit quality

"BBB" ratings indicate that expectations of default risk are currently low. The capacity for payment of financial commitments is considered adequate but adverse business or economic conditions are more likely to impair this capacity.

COUNTER PARTY LIST

Counterparty Name	Category	Average Long Term Credit Rating *	Comments	Investment Limit £	Maximum Term	Active in London money market	Return on Investments			Possible Additional Income Over UK Treasury Bills #	Change from 2011/12 Strategy
							3 Months	6 Months	1 Year		
United Kingdom Government	1	AAA		Unlimited	1,830 days	Often	0.40%	0.41%	n/a		
UK local authorities in England, Scotland & Wales	2	AA+		20,000,000	1,830 days	Often	0.35%	0.60%	0.65%	100,000	
HSBC Bank plc	3	AA		20,000,000	732 days	Sometimes					
Svenska Handelsbanken	3	AA-		20,000,000	732 days	Rarely					
Australia & New Zealand Banking Group	3	AA-		20,000,000	732 days	Rarely					New counterparty
Commonwealth Bank of Australia	3	AA-		20,000,000	732 days	Rarely					New counterparty
Westpac Banking Corporation	3	AA-		20,000,000	732 days	Rarely					New counterparty
Bank of Montreal	3	AA-		20,000,000	732 days	Rarely					
Bank Of Nova Scotia	3	AA-		20,000,000	732 days	Sometimes	0.53%	0.75%	1.00%		
Canadian Imperial Bank of Commerce	3	AA-		20,000,000	732 days	Rarely					
Royal Bank of Canada	3	AA		20,000,000	732 days	Rarely					
Toronto-Dominion Bank	3	AA		20,000,000	732 days	Rarely					
Nordia Bank AB	3	AA-		20,000,000	732 days	Rarely					
DBS Bank	3	AA		20,000,000	732 days	Often				120,000	
Overseas Chinese Banking Corp	3	AA		20,000,000	732 days	Often				120,000	
United Overseas Bank	3	AA		20,000,000	732 days	Often				120,000	
Rabobank Nederland NV	3	AA		20,000,000	732 days	Rarely					Reinstated following revised guidance from CIPFA
KW Bankengruppe	3	AAA		20,000,000	732 days	Rarely					New counterparty
Bank Nederlandse Gemeenten	3	AAA		20,000,000	732 days	Rarely					New counterparty
Inter-American Development Bank	3	AAA		20,000,000	732 days	Rarely					New counterparty
IBRD (World Bank)	3	AAA		20,000,000	732 days	Rarely					New counterparty
Global Treasury Funds Plc	3	AAA	Money Market Fund	20,000,000	Instant Access	Yes	0.75%	n/a	n/a	30,000	
Short Term Investment Company (Global Series) plc	3	AAA	Money Market Fund	20,000,000	Instant Access	Yes				30,000	
Goldman Sachs Sterling Liquid Reserve	3	AAA	Money Market Fund	20,000,000	Instant Access	Yes				30,000	
Scottish Widows Investment Partnership Global Liquidity Sterling Fund	3	AAA	Money Market Fund	20,000,000	Instant Access	Yes				30,000	
BNY Mellon Sterling Liquidity Fund	3	AAA	Money Market Fund	20,000,000	Instant Access	Yes				30,000	
Citibank	3	AAA	Money Market Fund	20,000,000	Instant Access	Yes				30,000	
Standard Life Sterling Liquidity Fund	3	AAA	Money Market Fund	20,000,000	Instant Access	Yes				30,000	
Barclays Bank	4	A+		15,000,000	366 days	Yes	0.98%	1.35%	1.89%	208,600	Reinstated following revised guidance from CIPFA
Standard Chartered Bank	4	A+		15,000,000	366 days	Rarely					Reinstated following revised guidance from CIPFA
ING Bank INV	4	A+		15,000,000	366 days	Rarely					Reinstated following revised guidance from CIPFA
Skandinaviska Enskilda Banken (SEB)	4	A+		15,000,000	366 days	Rarely					New Counter party
DNB Bank	4	A+		15,000,000	366 days	Rarely					
Deutsche Bank	4	A+		15,000,000	366 days	Rarely					
Landesbank Hessen-Thüringen	4	A+		15,000,000	366 days	Rarely					New Counter party
Credit Suisse	4	A+		15,000,000	366 days	Rarely					Reinstated following revised guidance from CIPFA
UBS AG	4	A+		15,000,000	366 days	Rarely					Reinstated following revised guidance from CIPFA
DZ Bank AG	4	AA-	S&P S/Term ratings A1	15,000,000	366 days	Rarely					New Counter party
National Bank of Canada	4	AA-	S/Term ratings F1 / A1	15,000,000	366 days	Rarely					
Royal Bank of Scotland plc	5	A		10,000,000	366 days	Yes	0.97%	1.35%	1.86%	146,000	Reinstated in new category
Nationwide Building Society	5	A		10,000,000	366 days	Often				146,000	Reinstated in new category
Swedbank AB	5	A		10,000,000	366 days	Rarely					New Counter party
Danske Bank	5	A-		10,000,000	366 days	Rarely					Reinstated in new category
Clydesdale Bank plc	5	A-		10,000,000	366 days	Often				146,000	Reinstated in new category
Lloyds TSB	6	A	Bank Financial Strength Rating C- on negative watch	6,000,000	366 days	Yes				89,600	Reinstated in new category
Yorkshire Building Society	6	BBB+		6,000,000	366 days	Often				89,600	New counterparty
Coventry Building Society	6	A-	Moody's S/Term Rating P2	6,000,000	366 days	Often				89,600	New counterparty
Leeds Building Society	6	A-	S/Term ratings F2 / P2	6,000,000	366 days	Yes	1.03%	1.36%	1.68%	89,600	New counterparty
Co-operative Bank plc	7	BBB+	Fitch S/Term Rating F2 Negative Watch	5,000,000	Overnight / Instant Access	Yes	1.53%	1.75%	2.44%		
Total										1,675,000	

Notes

* The long term credit ratings shown are adjusted to take account of possible future actions resulting from negative watches & outlooks. All negative watches & outlooks are assumed to result in a one notch downgrade.

In calculating possible additional income over & above the rate that can be earned on UK Treasury Bills, ie. the risk free rate, it is assumed that investments will be placed for

INVESTMENTS AT 30 JUNE 2012

Region	Counter Party	Minimum Long Term Credit Rating	Investment £
	Category 1 (unlimited up to 5 years)	AAA	
UK	UK Government Incl Debt Management Office		0
	Category 2 (£20m up to 5 years)		
UK	Other local authorities		127,750,000
	Category 3 (£20m up to 2 years)		
Asia	Banks	AA-	22,000,000
MMF	International Money Market Funds	AAA	29,032,000
UK	Banks	AA-	10,000,000
	Category 4 (£15m up to 1 year)		
UK	Banks	A+	10,000,000
EU	Banks	A	10,000,000
	Category 5 (£10m up to 1 year)		
UK	Banks		18,190,000
UK	Building societies		10,000,000
	Category 6 (£6m up to 1 year)		
UK	Building Societies	BBB	17,000,000
	Category 7 (£5m overnight)		
UK	Banks	BBB	0
	MMD Category (£2m)		
UK	MMD Insurance Loan		76,027
	Total		254,048,027