MEETING	**FULL COUNCIL**
DATE	**28 FEBRUARY 2013**
TITLE	**TREASURY MANAGEMENT** **TREASURY MANAGEMENT STRATEGY STATEMENT, MINIMUM REVENUE PROVISION STRATEGY AND ANNUAL INVESTMENT STRATEGY FOR 2013/14**
PURPOSE	**ADOPT THE PROPOSED STRATEGIES**
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CABINET MEMBER	**COUNCILLOR PEREDUR JENKINS**

Introduction and Background

1. The Code of Practice for managing Treasury Management in Public Services published by CIPFA, requires the Council to prepare a Policy Statement and practice papers together with detailed schedules setting out the Council's approach to all treasury operations. The primary requirement of the Code is the approval by the Full Council of the Policy Statement, the practice papers and the schedules. These were approved by the Council (in respect of 2012/13) at its meeting of 1st March 2012.

2. The Welsh Assembly Government's Statutory Guidance on Local Government Investments ("The Guidance"), requires the Council, as part of its treasury management function to prepare an Annual Investment Strategy. The Guidance states that authorities can combine the Treasury Management Strategy Statement and the Annual Investment Strategy into one report. Gwynedd Council has adopted that suggestion, therefore the Annual Investment Strategy is included as section 7 of **Appendix A.**

3. The Council is required by the Code and the Guidance to approve an annual Treasury Management Strategy Statement, Minimum Revenue Provision Strategy and an Annual Investment Strategy prior to the commencement of each financial year. The proposed strategy for 2013/14 is detailed herewith as **Appendix A.**

4. In addition, the Local Government Act 2003 introduced a new prudential framework for local authority's capital investment. The new arrangements, which were applicable from 1st April 2004 introduced a new system of governance for local authority capital expenditure, based largely on self regulation. The Prudential Code for Capital Finance in Local Authorities has been developed by CIPFA as a professional code of practice, with statutory backing, to support local authorities in taking decisions to spend capital. Key objectives are to ensure that the capital investment plans of local authorities are affordable, prudent and sustainable. Local authorities, before the beginning of each financial year, are required to set certain prudential indicators for the forthcoming and following years. Following the recent review, CIPFA has now introduced a new prudential indicator, "Upper limits on the proportion of net debt to gross debt" to highlight where an authority may be borrowing in advance of its cash requirement. The indicators, which are based on the capital and revenue budget proposals contained elsewhere on the agenda, are shown here in **Appendix B**.

5. The counterparties currently meeting investment criteria **(Appendix C)** have been updated to reflect the latest recommendations. The maximum length of loans to all institutions has been increased from 1 year to 2 years to reflect these recommendations. The maximum limit and length of investments are listed, although they are currently restricted to 1 year or less, depending on the status of each institution.

6. With effect from 31st March 2008, the Welsh Assembly Government introduced the Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2008 [the "Amendment Regulations"]. These Regulations introduce certain amendments to those introduced in 2003 [the "Original Regulations"] as part of the implementation of the Prudential Borrowing regime. Amongst the changes introduced is the requirement for an Annual Minimum Revenue Provision (MRP) Policy Statement.

7. The Original Regulations set out a statutory basis and a complex formula for the calculation of MRP. The Amendment Regulations only require a charge that is 'prudent', and authorities are permitted more discretion in terms of the charge levied, albeit within certain parameters. The attached strategy in Section 10 of **Appendix A** herefore also incorporates the Annual MRP Statement for 2013/14.

8. Members of the Audit Committee and the Cabinet Member for Resources were invited to a briefing meeting on 29 January 2013 with Arlingclose, the Council's Treasury Advisors, to discuss Treasury Management. Members were reminded of CIPFA's Code of Practice for Treasury Management as well as their roles and responsibilities as members for the Treasury Management function. The advisors highlighted the various current treasury risks, and spoke in detail about the credit and counterparty risks, interest rate risks and inflation risk. They also discussed the Council's debt portfolio, net borrowing position, and the prudential indicators.

9. All of the following papers were presented to the Audit Committee on 14 February, where proposals were explained and generally accepted, further to questions from Members. The Audit Committee decided to recommend to the full Council as follows:

Recommendation

10. The Council is asked to adopt the Treasury Management Strategy Statement, MRP Strategy and the Annual Investment Strategy for 2013/14 (Appendix A), the Prudential Indicators (Appendix B) and the Treasury Management Schedules (Appendix C).

APPENDIX A

TREASURY MANAGEMENT STRATEGY STATEMENT AND INVESTMENT STRATEGY 2013/14 TO 2015/16

1. Background

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

1.2 As per the requirements of the Prudential Code, the Council has adopted the CIPFA Treasury Management Code at a meeting of its Full Council on 3rd March 2011.

1.3 The purpose of this Treasury Management Strategy Statement is, therefore, to approve:

- Treasury Management Strategy for 2013/14;
- Annual Investment Strategy for 2013/14;
- Prudential Indicators for 2013/14, 2014/15 and 2015/16;
- Minimum Revenue Provision (MRP) Statement;
- Revisions to Treasury Management Strategy and Prudential Indicators for 2012/13.

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

2. Capital Financing Requirement

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

2.2 The Council's current level of debt and investments is shown below:

	31 December 2012 £m
External Borrowing: Fixed Rate – PWLB Fixed Rate – Market	 96.6 16.2
Other Long term Liabilities Finance Leases	 0.0
Total External Debt	**112.8**
Total Investments	**(63.2)**
Net Borrowing Position	**49.6**

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

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

Table 1: Balance Sheet Summary Analysis

	2012/13 Estimate £m	**2013/14 Estimate £m**	**2014/15 Estimate £m**	**2015/16 Estimate £m**
Capital Financing Requirement (CFR)	156.06	160.31	165.38	167.66
Less: Existing Profile of Borrowing	(113.09)	(111.97)	(115.98)	(120.98)
Less: Other Long Term Liabilities	0	0	0	0
Cumulative Maximum External Borrowing Requirement	**42.97**	**48.34**	**49.40**	**46.68**
Usable Reserves	(63.45)	(57.02)	(55.37)	(56.25)
Cumulative Net Borrowing Requirement / (Investments)	**(20.48)**	**(8.68)**	**(5.97)**	**(9.57)**

1. Interest Rate Forecast

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

3.2 The economic and interest rate forecast shown below is provided by the Council's treasury management advisor, Arlingclose Ltd. The Council will reappraise its strategies from time to time in response to evolving economic, political and financial events.

	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Official Bank Rate													
Upside risk			0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk		-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
3-month LIBID													
Upside risk	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75
Central case	0.40	0.40	0.40	0.45	0.45	0.50	0.50	0.50	0.55	0.55	0.55	0.60	0.60
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
1-yr LIBID													
Upside risk	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75
Central case	0.85	0.90	0.95	0.95	1.00	1.00	1.00	1.00	1.10	1.10	1.10	1.10	1.10
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
5-yr gilt													
Upside risk	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00
Central case	0.95	0.95	0.95	0.95	1.00	1.00	1.00	1.00	1.10	1.10	1.10	1.20	1.20
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
10-yr gilt													
Upside risk	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.00	1.00
Central case	2.00	2.00	2.05	2.05	2.05	2.05	2.10	2.10	2.10	2.20	2.20	2.20	2.20
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
20-yr gilt													
Upside risk	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00
Central case	2.90	2.90	2.90	2.90	3.00	3.00	3.00	3.00	3.10	3.10	3.10	3.10	3.10
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
50-yr gilt													
Upside risk	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00
Central case	3.35	3.35	3.35	3.40	3.40	3.40	3.50	3.50	3.50	3.50	3.60	3.60	3.60
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25

Underlying Assumptions:

- UK growth is unlikely to return to above trend for the foreseeable future. Q3 GDP was strong at 0.9% but this momentum is unlikely to be sustained in Q4 or in 2013. The rebalancing from public-sector driven consumption to private sector demand and investment is yet to manifest, and there is little sign of productivity growth. Further contraction in the Eurozone, including Germany's powerful economy, and slower forecast growth in the emerging economies (Brazil/Mexico/India) are exacerbating the weakness.

- Consumer Price Inflation has fallen to 2.7 % from a peak of 5.2%. Near term CPI is likely to be affected by volatility in commodity prices and its decrease towards the 2% target is expected to be slower than previously estimated. Real wage growth (i.e. after inflation) is forecast to remain weak.

- The fiscal outlook for bringing down the structural deficit and stabilising debt levels remains very challenging. Weakened credibility of the UK reining in its levels of debt poses a risk to the AAA status, but recent history (US, France) suggests this may not automatically result in a sell-off in gilts.

- In the absence of large, unexpected decline in growth, QE is likely to remain on hold at £375bn for now. The availability of cheaper bank borrowing and subsequently for corporates through the Funding for Lending Scheme (FLS) is a supporting factor.

- The US Federal Reserve's shift in its rate guidance from a date-based indication to economic thresholds (6.5% unemployment, inflation 1 – 2 years out projected to remain below 2.5%, longer term inflation expectations remain well anchored) is likely to increase market uncertainty around the highly volatile US employment data releases.

- The Eurozone is making slow headway which has curtailed some of the immediate risks, although peripheral countries continue to struggle. Fully-fledged banking and fiscal union is still some years away.

- In the US, the issues of spending cuts, reducing the budget deficit and raising the country's debt ceiling remain unresolved. A failure to address these by March 2013 could lead to another showdown and risks a downgrade to the US sovereign credit rating by one or more agencies.
- A reversal in market risk sentiment from current "risk on" to "risk off" could be triggered by economic and/or political events – impending Italian and German elections, US debt ceiling impasse, difficulty surrounding Cyprus' bailout, and contagion returning the haunt the European peripheral nations – and could inject renewed volatility into gilts and sovereign bonds.

4. Borrowing Strategy

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

4.2 As indicated in Table 1, the Council has a gross borrowing requirement of £48.34m in 2013/14 but has sufficient balances and reserves to avoid the need for external borrowing. By essentially lending its own surplus funds to itself the Council is able to minimise borrowing costs and reduce overall treasury risk by reducing the level of its external investment balances.

5. Sources of Borrowing and Portfolio Implications

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

- Internal
- PWLB
- Local authorities
- European Investment Bank Leasing
- Structured finance
- Capital markets (stock issues, commercial paper and bills)
- Commercial banks

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

5.3 The Council has £16.2m exposure to LOBO loans (Lender's Option Borrower's Option) of which £16.2m of these can be "called" within 2013/14. A LOBO is called when the Lender exercises its right to amend the interest rate on the loan at which point the Borrower can accept the revised terms or reject them and repay the loan. LOBO loans present a potential refinancing risk to the Council since the decision to call a LOBO is entirely at the lender's discretion.

Any LOBOs called will be discussed with the treasury advisers prior to acceptance of any revised terms. The default position will be the repayment of the LOBO without penalty i.e. the revised terms will not be accepted. Based on the Balance Sheet summary at Table 1, new external borrowing would ultimately be required to fund any potential repayment.

6. Debt Rescheduling

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

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

- Reduce investment balances and credit exposure via debt repayment
- Align long-term cash flow projections and debt levels
- Savings in risk adjusted interest costs
- Rebalancing the interest rate structure of the debt portfolio
- Changing the maturity profile of the debt portfolio

6.3 Borrowing and rescheduling activity will be reported to the Audit Committee in the Annual Treasury Management Report and the mid-year treasury management report presented to the Audit Committee.

7. Annual Investment Strategy

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

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

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

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

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

Table 2: Specified and Non-Specified Investments

Investment	**Specified**	**Non-Specified**
Debt Management Account Deposit Facility	✓	✗
AAA-Rated Money Market Funds	✗	✓
Treasury Bills (T-Bills)	✓	✗
Local Authority Bills	✓	✗
Term deposits with other UK local authorities	✓	✓
Term deposits with banks and building societies	✓	✓
Certificates of deposit with banks and building societies	✓	✓
Gilts	✓	✓
Bonds issued by Multilateral Development Banks	✓	✓
Corporate Bonds	✓	✓
Other Money Market and Collective Investment Schemes	✓	✓
Commercial Paper	✓	✗
Investments with Registered Providers	✓	✓
Investments with other organisations which do not meet investment criteria (subject to an external credit assessment)	✗	✓
Business Loans to Local Companies (as agreed by the Local Loans Fund scheme)*	✗	✓

**Advancement of these loans will be approved by the procedure noted below. Evaluation of the Business Loans is not part of the advice or services from the Council's treasury advisor.*

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

7.6 Investments with other organisations have been included as a non-specified investment category for 2013/14. This would include investment opportunities with small and medium sized enterprises (SMEs) and other businesses across the UK. Because of the higher perceived credit risk of SMEs, such investments may provide considerably higher rates of return. An external credit assessment will be undertaken and advice from the Council's TM adviser will be sought (where available) before any investment decision is made.

7.7 The minimum credit rating for non-UK sovereigns is AA+ (or equivalent). For specified investments the minimum long term rating for counterparties is A- (or equivalent). As detailed in non-specified investments in Appendix C, the Head of Finance will have discretion to make investments with counterparties that do not meet the specified criteria on advice from Arlingclose.

The other credit characteristics, in addition to credit ratings, that the Council monitors are listed in the Prudential Indicator on Credit Risk (PI 11, page 16).

Any institution will be suspended or removed should any of the factors identified above give rise to concern. Specifically credit ratings are monitored by the Council at least monthly, although any rating changes to institutions on the Council's counterparty list are communicated by its Treasury Advisors as they occur. When Arlingclose advises the Council on ratings changes and appropriate action to be taken this is implemented. The counterparties currently meeting the criteria are shown in **Appendix C**.

The Council has set up a Local Loans Fund which will make loans to local businesses. These investments are included in the Non-Specific Investments table above and will be for a maximum period of 10 years. The total value of the fund for such investments is £3million. Applications for loans under this scheme will not be part of the usual credit assessment for treasury management investment purposes but will be assessed by appointed consultants and any decision to lend will be made by the Investment Panel for the scheme.

7.8 **Council's Banker –** The Council banks with Barclays Bank plc. At the current time, it does meet the Council's minimum credit criteria. Even if the credit rating falls below the Council's minimum criteria it will continue to be used for short term liquidity requirements (overnight and weekend investments) and business continuity arrangements.

8. Investment Strategy

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

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

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

9. Policy on Use of Financial Derivatives

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

9.2 In the absence of any legislative power, the Council's policy is not to enter into standalone financial derivatives transactions such as swaps, forwards, futures and options. Embedded derivatives will not be subject to this policy, although the risks they present will be managed in line with the overall risk management strategy.

10. 2013/14 MRP Statement

10.1 The Local Authorities (Capital Finance and Accounting)(Wales)(Amendment) Regulations 2008 (SI 2008/588 (W.59)) place a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Welsh Ministers and local authorities are required to "have regard" to such Guidance under section 21(1B) of the Local Government Act 2003.

10.2 The four MRP options available are:

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

NB This does not preclude other prudent methods.

10.3 MRP in 2013/14: Options 1 and 2 may be used only for supported (i.e. financing costs deemed to be supported through Revenue Support Grant from Central Government) Non-HRA capital expenditure funded from borrowing. Methods of making prudent provision for unsupported Non-HRA capital expenditure include Options 3 and 4 (which may also be used for supported Non-HRA capital expenditure if the Council chooses).

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

The Council will apply Option 1 in respect of supported capital expenditure funded from borrowing, and Option 3 in respect of unsupported capital expenditure funded from borrowing.

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

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

11.1 The Head of Finance will report to the Audit Committee on treasury management activity/performance and Performance Indicators every six months against the strategy approved for the year. The Council will produce an outturn report on its treasury activity no later than 30th September after the financial year end.

The Audit Committee will be responsible for the scrutiny of treasury management activity and practices.

12. Other Items

12.1 Training

In accordance with CIPFA's Code of Practice, the Head of Finance shall ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs, and that they understand their roles and responsibilities.

12.2 Treasury Management Advisors

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

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

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

APPENDIX B

Prudential Indicators 2013/14 – 2015/16

1. Background:

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

2. Gross Debt and the Capital Financing Requirement:

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

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

The Head of Finance reports that the Council had no difficulty meeting this requirement in 2012/13, nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

Where **the gross debt is greater than the capital financing requirement the reasons** for this should be clearly stated in the annual treasury management strategy.

3. Estimates of Capital Expenditure:

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

Capital Expenditure	2012/13 Approved £m	2012/13 Revised £m	2013/14 Estimate £m	2014/15 Estimate £m	2015/16 Estimate £m
Non-HRA	61.44	40.88	50.70	31.27	20.35
HRA	0	0.06	0	0	0
Total	**61.44**	**40.94**	**50.70**	**31.27**	**20.35**

3.2 Capital expenditure will be financed or funded as follows:

Capital Financing	2012/13 Approved £m	2012/13 Revised £m	2013/14 Estimate £m	2014/15 Estimate £m	2015/16 Estimate £m
Capital receipts	1.89	2.28	1.07	2.10	0.68
Government Grants	31.13	19.58	25.68	16.42	7.32
Revenue contributions	13.92	8.98	13.46	1.28	3.49
Total Financing	**46.94**	**30.84**	**40.21**	**19.80**	**11.49**
Supported borrowing	4.89	4.86	4.17	4.17	4.17
Unsupported borrowing	9.61	5.24	6.33	7.30	4.68
Total Funding	**14.50**	**10.10**	**10.49**	**11.47**	**8.85**
Total Financing and Funding	**61.44**	**40.94**	**50.70**	**31.27**	**20.34**

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

4. Ratio of Financing Costs to Net Revenue Stream:

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

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

Ratio of Financing Costs to Net Revenue Stream	2012/13 Approved %	2012/13 Revised %	2013/14 Estimate %	2014/15 Estimate %	2015/16 Estimate %
Total	**5.65**	**5.54**	**5.24**	**5.24**	**5.37**

5. Capital Financing Requirement:

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

Capital Financing Requirement	2012/13 Approved £m	2012/13 Revised £m	2013/14 Estimate £m	2014/15 Estimate £m	2015/16 Estimate £m
Total CFR	**162.03**	**156.14**	**160.39**	**165.46**	**167.74**

6. Incremental Impact of Capital Investment Decisions:

6.1 This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

Incremental Impact of Capital Investment Decisions	2012/13 Approved £	2013/14 Estimate £	2014/15 Estimate £	2015/16 Estimate £
Increase in Band D Council Tax	0.0	0.0	0.0	0.0

6.2 The Council's capital plans, as estimated in forthcoming financial years, have a neutral impact on council tax. This reflects the fact that capital expenditure is predominantly financed from internal resources (grants, contributions, revenue and capital receipts) and that any increase in the underlying need to borrow is supported through the Revenue Support Grant system.

7. Authorised Limit and Operational Boundary for External Debt:

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

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

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

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

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

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

	2012/13 Approved £m	**2012/13 Revised £m**	**2013/14 Estimate £m**	**2014/15 Estimate £m**	**2015/16 Estimate £m**
Authorised Limit for Borrowing	189.75	190.0	190.0	190.0	190.0
Authorised Limit for Other Long-term Liabilities	0.25	0.00	0.00	0.00	0.00
Authorised Limit for External Debt	**190.00**	**190.00**	**195.00**	**195.00**	**195.0**
Operational Boundary for Borrowing	169.75	170.00	170.00	170.00	170.00
Operational Boundary for Other Long-term Liabilities	0.25	0.00	0.00	0.00	0.00
Operational Boundary for External Debt	**170.00**	**170.00**	**175.00**	**175.00**	**175.00**

8. Adoption of the CIPFA Treasury Management Code:

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

Adoption of the CIPFA Code of Practice in Treasury Management
The Council approved the adoption of the CIPFA Treasury Management Code at its full Council meeting on 3rd March 2011.

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

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

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

9.2 The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises which could adversely impact on the revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments.

	Existing level at 31/03/12 %	**2012/13 Approved %**	**2012/13 Revised %**	**2013/14 Estimate %**	**2014/15 Estimate %**	**2015/16 Estimate %**
Upper Limit for Fixed Interest Rate Exposure	69.3	100	100	100	100	100
Upper Limit for Variable Interest Rate Exposure	0	50	50	50	50	50

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

10. Maturity Structure of Fixed Rate borrowing:

10.1 This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

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

10.3 LOBOs are classified as maturing on the next call date, i.e. the earliest date that the lender can require repayment.

Maturity structure of fixed rate borrowing	Existing proportions at 31/03/12 %	Lower Limit for 2013/14 %	Upper Limit for 2013/14 %
under 12 months	1.10	0	25
12 months and within 24 months	15.21	0	25
24 months and within 5 years	2.42	0	50
5 years and within 10 years	6.08	0	75
10 years and within 20 years	20.78	0	100
20 years and within 30 years	30.38	0	100
30 years and within 40 years	0	0	100
40 years and within 50 years	24.03	0	100
50 years and above	0	0	100

11. Credit Risk:

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

11.2 Credit ratings (as supplied by credit rating agencies) remain an important element of assessing credit risk, but they are not a sole feature in the Council's assessment of counterparty credit risk.

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

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

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

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

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

	2012/13 Approved £m	**2012/13 Revised £m**	**2013/14 Estimate £m**	**2014/15 Estimate £m**	**2015/16 Estimate £m**
Upper Limit for total principal sums invested over 364 days	40.0	35.0	35.0	35.0	35.0

APPENDIX C

COUNTERPARTIES CURRENTLY MEETING INVESTMENT CRITERIA

Country	Counterparty	Maximum Limit of Investments £m	Maximum Length of Loans
UK	DMADF, DMO	No Limit	No Limit
UK	UK Local Authorities	£30m (£30m)	2 years
UK	Santander UK Plc (Banco Santander Group)	£12m (£18m)	2 years
UK	Bank of Scotland (Lloyds Banking Group)	£12m (£18m)	2 years
UK	Lloyds TSB (Lloyds Banking Group)	£12m (£18m)	2 years
UK	Barclays Bank Plc	£12m (£18m)	2 years
UK	Clydesdale Bank (National Australia Bank Group)	£12m (£18m)	2 years
UK	HSBC Bank Plc	£12m (£18m)	2 years
UK	Nationwide Building Society	£12m (£18m)	2 years
UK	NatWest (RBS Group)	£12m (£18m)	2 years
UK	Royal Bank of Scotland (RBS Group)	£12m (£18m)	2 years
UK	Standard Chartered Bank	£12m (£18m)	2 years
Australia	Australia and NZ Banking Group	£12m (£18m)	2 years
Australia	Commonwealth Bank of Australia	£12m (£18m)	2 years
Australia	National Australia Bank Ltd (National Australia Bank Group)	£12m (£18m)	2 years
Australia	Westpac Banking Corp	£12m (£18m)	2 years
Canada	Bank of Montreal	£12m (£18m)	2 years
Canada	Bank of Nova Scotia	£12m (£18m)	2 years
Canada	Canadian Imperial Bank of Commerce	£12m (£18m)	2 years
Canada	Royal Bank of Canada	£12m (£18m)	2 years
Canada	Toronto-Dominion Bank	£12m (£18m)	2 years
Finland	Nordea Bank Finland	£12m (£18m)	2 years
Finland	Pohjola	£12m (£18m)	2 years
France	BNP Paribas	£12m (£18m)	2 years
France	Credit Agricole CIB (Credit Agricole Group)	£12m (£18m)	2 years
France	Credit Agricole SA (Credit Agricole Group)	£12m (£18m)	2 years
France	Société Générale	£12m (£18m)	2 years
Germany	Deutsche Bank AG	£12m (£18m)	2 years
Netherlands	ING Bank NV	£12m (£18m)	2 years
Netherlands	Rabobank	£12m (£18m)	2 years
Netherlands	Bank Nederlandse Gemeenten	£12m (£18m)	2 years
Singapore	DBS Bank Ltd	£12m (£18m)	2 years
Singapore	Oversea-Chinese Banking Corporation (OCBC)	£12m (£18m)	2 years
Singapore	United Overseas Bank (UOB)	£12m (£18m)	2 years
Sweden	Svenska Handelsbanken	£12m (£18m)	2 years
Switzerland	Credit Suisse	£12m (£18m)	2 years
US	JP Morgan	£12m (£18m)	2 years

1. There is a limit of £18m on banks within the same banking group.
2. The time limits in the above list relate to term deposits. Negotiable/tradable instruments such as CD’s are subject to a 5 year limit. Current recommended duration limits are considerably lower than this, but the limits outlined above provide flexibility to react to the possiblity of continued stabilisation or improvement in credit and economic conditions in 2013/14.
3. This list could change if, for example, a counterparty/country is upgraded, and meets our other creditworthiness tools. Alternatively, if a counterparty is downgraded, this list may be shortened.

Non-Specified Investments

Instrument	**Maximum maturity**	**Max £m of portfolio**	**Capital expenditure?**	***Examples***
Term deposits with banks and building societies which meet the specified investment criteria	2 years	£12m per counterparty	No	
Term deposits with local authorities	2 years	£12m per counterparty	No	
CD's and negotiable instruments with banks and building societies which meet the specified investment criteria*	5 years	£12m per counterparty	No	
Investments with banks, building societies and other organisations which do not meet the specified investment criteria* (subject to and external credit assessment) (with authority of s151 officer)	3 months	£5m per counterparty	No	*Bank falling below criteria specified e.g. Co-op* *Small and medium enterprises (SME's)*
	1 year	£1m per counterparty	No	
	5 years	£100k per counterparty	Yes / No	
		Subject to a maximum of £20m overall		
Deposits with registered providers	5 years	£5m	No	*Housing Associations, Registered Social Landlords*
Gilts	6 years	No limit	No	*DMO*
Bonds issued by multilateral development banks	6 years	£12m	No	*EIB Bonds, Council of Europe Bonds etc.*
Sterling denominated bonds by non-UK sovereign governments	6 years	£12m	No	
Money Market Funds and Collective Investment Schemes	Daily liquidity	£8m per name £37.5m in total.	Yes	*Ignis Sterling Liquidity Fund, Federated Prime Rate Sterling Liquidity Fund, RBS Global Treasury Funds etc.* *Investec Target Return Fund; Elite Charteris Premium Income Fund; LAMIT; M&G Global Dividend Fund*
Corporate and debt instruments issued by corporate bodies purchased from 01/04/12 onwards	2 years	£5m	No	
Collective Investment Schemes (pooled funds) which do not meet the definition of collective investment schemes in WSI 2004 No 1010 (W.107) or WSI 2007 No 1051 (W.108)	These funds do not have a defined maturity date	£5m	Yes / No	*Way Charteris Gold Portfolio Fund; Lime Fund*
Deposits with other organisations in relation to mortgage deposit schemes (with authority of s151 officer in consulation with the Council's treasury advisor).	7 years	£1m	No	*LAMS*
Business loans to local companies **	10 years	£3m	Yes / No	

* Investment in these instruments will be on advice from the Council's treasury advisor.

** Advancement of these loans will be approved by the procedure detailed in the final paragraph of part 7.7 of Appendix A. Evaluation of the Business Loans is not part of the advice or services from the Council's treasury advisor.

The Council will have a maximum of 75% of its investment portfolio in non-specified investments.