TORBAY COUNCIL

Meeting: **Audit Committee** **Date:** **22nd January 2014**
Council **6th February 2014**

Wards Affected: All Wards in Torbay

Report Title: Treasury Management Strategy 2014/15 (incorporating the Annual Investment Strategy 2014/15 and the Minimum Revenue Provision Policy 2014/15)

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1. Purpose and Introduction

1.1 The Strategy outlined in this report aims to support the provision of all Council services by the management of the Council's cash flow, debt and investment operations in 2014/15 and effectively control the associated risks and the pursuit of optimum performance consistent with those risks.

1.2 The overall objectives of the Treasury Management Strategy are:

- To ensure sufficient funding is available for day-to-day activities and capital projects through effective cash flow management
- To seek to reduce the impact on the revenue account of net interest costs through optimal levels of borrowing and investment
- To prioritise control of risks in investing cash and to then achieve maximum returns from those investments commensurate with proper levels of security and liquidity.

2. Proposed Decisions

<u>Audit Committee</u>

2.1 It is recommended that Audit Committee endorse the Treasury Management Strategy for 2014/15.

<u>Council</u>

2.2 The Council is recommended to approve the Treasury Management Strategy for 2014/15 (incorporating the Annual Investment Strategy 2014/15) set out at Appendix 1 to this Report;

2.3 The Council is recommended to approve the Prudential and Treasury Indicators 2014/15 laid out in Annex 1 of this report;

2.4 The Council is recommended in line with the Council's Constitution and Financial Regulations to approve:

(i) that the Chief Finance Officer be authorised to take any decisions on borrowing and investments. (Delegations to the Section 151 Officer, paragraph 3.1(a)); and

(ii) that the Chief Finance Officer be authorised to invest temporarily or utilise surplus monies of the Council; (Financial Regulations, paragraph 14.5);

2.5 The Council is recommended to approve the Annual Minimum Revenue Provision Policy Statement for 2014/15 as shown in Annex 2 to this report.

3. Reason for Decisions

3.1 The Treasury Management Strategy is considered under a requirement of the CIPFA Code of Practice on Treasury Management which was adopted by the Council on 25th March 2010.

3.2 The approval of an Annual Investment Strategy by Council is a requirement of the Guidance on Local Government Investments issued by the Secretary of State under section 15(1)(a) of the Local Government Act 2003. This sets out the Council's policies for managing its investments under the priorities of security first, liquidity second and then returns.

3.3 In addition, the Local Government Act 2003 requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

3.4 Under CLG regulations the Council is required to approve a Minimum Revenue Provision (MRP) Statement in advance of each year.

Supporting Information

4. Position

4.1 The Council defines its treasury management activities as:

"The management of the authority's investments and cash flows, it's 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".

4.2 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This report, together with the rolling Capital Investment Plan, forms an integrated strategy to ensure the affordability of capital projects.

4.3 The provisional 2014/15 budget for interest payments has therefore been set at a level which will cover the Council's borrowing requirements in the Capital Investment Plan together with cash flow costs arising from capital projects.

4.4 The interest receipts budget for 2014/15, which is directly linked to the Council's borrowing position, is based on an average investment balance of £67 million and an average investment rate of 0.84% (the estimate for 2013/14 was 1.45%). This includes monies held by the Council's external Fund Manager and exceeds the benchmark rate forecast to remain at around 0.50%

4.5 The budget for payment of interest on debt for 2014/15 is based on an overall borrowing rate of 4.39% which (the estimate for 2013/14 was 4.31%).

4.6 The core balances for which cash backing is required reflects the level of Council reserves, provisions, unapplied grants and contributions and working capital. This links to the Capital Investment Plan and Medium Term Resource Plan which form the basis of the Council's longer term strategic cash flow forecasts.

4.7 The proposed strategy for 2014/15 is set out in full at Appendix A to this report and covers the following:

- Prudential and Treasury Indicators;
- Capital expenditure and the Capital Financing Requirement
- the minimum revenue provision (MRP) policy
- prospects for interest rates;
- economic conditions and scenario planning;
- the borrowing strategy;
- the Annual Investment Strategy;
- policy on use of external service providers;
- reporting arrangements and management evaluation;
- other matters

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

4.8 The key points of the proposed strategy are:

* **Little or no increase in interest rates forecasts in 2014/15 but contingency plans to act if rates do move;**
* **A steady but slow increase in the level of the Capital Financing Requirement primarily linked to the South Devon Link Road**
* **MRP generates £4.5million per year for repayment of borrowing**
* **The Council will seek to early repay up to £10million of borrowing over the next four years on sufficiently favourable movement in rates**

* **Opportunity to repay will not be assumed within the budget and investment strategy will be based on current projected cash levels;**
* **The number of suitable investment counterparties is very limited**
* **Enhanced Investment rates available to local authorities are falling as a result of the Government's Funding for Lending scheme.**
* **An element of core cash levels will, where possible, be exposed to deposits of around one year duration predominantly in the UK part-nationalised Banks.**
* **The possibility of a rise in investment rates will be mitigated by use of short-term variable rate instruments.**

5. Possibilities and Options

5.1 Not applicable.

6. Fair Decision Making

6.1 Not applicable

7. Public Services (Social Value) Act 2012

7.1 Not applicable

8. Consultation

8.1 Not applicable

9. Risks

9.1 The main risks to Treasury Management activities will arise from interest rate levels and volatility, liquidity and cash flow requirements and creditworthiness of investment counterparties.

9.2 The management of specific risks is outlined in the Treasury Management Practices as required by the CIPFA Code of Practice approved by Council on 25th March 2010. Detailed controls are set by the Chief Financial Officer within the Schedules to the Treasury Management Practices and these are reviewed annually.

9.3 Other sections of this report below deal further with risk management and mitigation of particular elements of the 2014/15 Strategy.

Appendices

Appendix A	Treasury Management Strategy 2014/15
Annex 1	Prudential and Treasury Management Indicators
Annex 2	Policy on Minimum Revenue Provision for 2014/15
Annex 3	Interest Rate Forecasts 2014 – 2017
Annex 4	Economic Background
Annex 5	Creditworthiness Policy
Annex 6	Specified and Non-specified Investments

Appendix A

Treasury Management Strategy 2014/15

This Appendix sets out full details for all aspects of the Treasury Management Strategy for 2014/15.

A1 Prudential Indicators and Treasury Indicators

Local Authorities are required to set indicators to demonstrate they have fulfilled the objectives of the Prudential Code and CIPFA Code of Practice on Treasury Management. The indicators for 2014/15 and future years are set out at Annex1

A2 Capital Expenditure and the Capital Financing Requirement

A2.1 Capital expenditure plans are a key element of treasury management activity and form the first of the Prudential Indicators at Annex 1. Figures are as per the Capital Investment Plan Quarter 2 2013/14 report and are summarised below.

Capital expenditure £M	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Total	**23.6**	**24.6**	**23.3**	**10.2**	**5.0**	**0**

A2.2 The figures include a borrowing requirement of £32M over the medium term of which up to £8.6M is temporary awaiting confirmation of capital income.

A2.3 These plans feed into the overall Capital Financing Requirement (CFR) which is explained at Annex 1 and summarised below.

CFR £M	**2012/13 Actual**	**2013/14 Revised Estimate**	**2014/15 Estimate**	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**
Total	**136**	**142**	**146**	**150**	**150**	**145**

A3 Minimum Revenue Provision (MRP) policy statement

A3.1 The Council is required to set aside an amount for the repayment of borrowing used for capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP). It is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

A3.2 CLG regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision.

A3.3 The MRP Policy for 2014/15 is set out at Annex 2 to this report.

A4 Core funds and expected investment balances

A4.1 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources £M	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Reserves	36	27	21	19	18	18
Provisions	0	1	1	1	1	1
Other Balances	11	6	9	7	5	3
Total core funds	**47**	**34**	**37**	**27**	**24**	**22**
Working capital	16	15	15	15	15	15
Total Cash Requirement	**63**	**59**	**52**	**42**	**39**	**37**
Excess LTL>CFR	21	5	1	(4)	(4)	(4)
Expected Investments	**84**	**64**	**53**	**46**	**43**	**41**

A5 Prospects for Interest Rates

A5.1 The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Annex 3 draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Capita central view.

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Dec 2013	0.50	2.50	4.40	4.40
March 2014	0.50	2.50	4.40	4.40
March 2015	0.50	2.80	4.60	4.70
March 2016	0.50	3.10	5.00	5.10
March 2017	1.25	3.40	5.10	5.20

A5.2 These levels are artificially low in the short term due to Bank of England policies, market conditions and the impact of quantitative easing.

A5.3 **Sensitivity of Forecasts.** The projections within this report are based on officers "central" view of market rates applicable in 2014/15. These are subject to variation from interest rate changes and cash flow changes. An illustration of the potential impact of these changes is shown in the following table:

Variation	Central Case	Change +/-	£ Variation*
Change in Investment rates (new investments)	0.84%	1%	£0.67 million
Change in Borrowing Rates (change in penalty cost on early repayment of an indicative £5 million)**	n/a	1%	-£0.6million/ +£0.5 million
Change in Average cash flow (assume increased investments)	£67 million	£10 million	£0.05 million

** Based on current levels of borrowing and investment*

***The strategy provides for no additional borrowing in 2014/15 for capital funding and all existing borrowing is at fixed rate so any change in Borrowing Rates will have no effect on interest payable*

A5.4 The above gives rise to difficult conditions for implementing the proposed strategy and the need for Treasury Management officers to remain agile and react to any changes in Bank of England policy or market sentiment.

A6 Economic Conditions and Scenario Planning

A6.1 A commentary on the economic background to this strategy, issued by Capita, is provided at Annex 4.

A6.2 The uncertainty of economic conditions within the UK, Eurozone and USA will continue to have a significant impact on the Council's Treasury Management function.

A6.3 The Council is still facing a situation where Bank Rate and therefore investment returns are at record lows, well below the level payable on borrowings.

A6.4 The Council has linked its medium term financial planning to the continuing uncertain conditions. The impact of these conditions on the Councils investment budget has been identified and has formed part of the budget planning process for future years.

A6.5 The current economic conditions are still very unpredictable and as a result there are a range and potential speed of market movements that could occur over the next few years which will provide a challenge to officers. The current strategy and budgets reflect that uncertainty and are based on prudent views of market movements and counterparty limits are set to minimise the Council's exposure to risk.

A6.6 The latent crisis in the Eurozone and the potential effect on markets will continue to be monitored by Officers for threats to treasury activities. The Council currently has a blanket duration limit of three months on all deposits (except to UK part-nationalised banks) to mitigate potential risks arising from the problems in Greece and other countries.

A6.7 Varying the Council's counterparty limits could increase or decrease investment yield with a corresponding change in the level of security (risk) over the counterparty. In the current market conditions any extension of counterparty limits and maximum length of investments could increase investment yield. However this would need to be considered against the higher risk of impairment.

A6.8 The government has sold off 6% of its share in Lloyds Banking Group and indicated it will continue to reduce its stakeholding. The CFO will monitor the level of government support in the part-nationalised Banks and will adjust the exposure limits as appropriate.

A6.9 The charge from the Minimum Revenue Provision policy (see section A3 and Annex2) generates £4.5 million (excluding PFI) per year for repayment of borrowing or postponement of new borrowing. Current credit and interest risk environments give rise to a preferred repayment strategy to reduce cost and cash levels.

A7 Borrowing Strategy

A7.1 The following table provides an analysis of current borrowing levels against the Capital Financing Requirement (CFR) derived from the approved Capital Investment Plan. This also forms one of the Prudential Indicators at Annex 1.

£m	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
External Debt at 31 March						
External Borrowing	148	138	138	138	138	134
Other long-term liabilities (OLTL)*	9	9	9	8	8	7
Total Borrowing and Other Long Term Liabilities	**157**	**147**	**147**	**146**	**146**	**141**
The Capital Financing Requirement	**136**	**142**	**146**	**150**	**150**	**145**

* *Assumes Energy from Waste costs are off –balance sheet. If the PFI scheme is required to be shown on-balance sheet the Council's long-term liabilities would increase by approximately £50million from 2014/15*

A7.2 In previous years, based on approved capital schemes and with uncertainty over market and regulatory risks, the Council adopted a strategy to take full funding of its capital borrowing in advance prior to predicted rate increases. Following changes to the Capital Investment Plan in terms of timing of both expenditure and funding, an element of borrowing has been surplus to capital financing requirements over the medium term.

A7.3 Recent annual strategies have recommended seeking opportunities to repay borrowing to realign funding levels between the revised Capital Investment Plan and projected Capital Financing Requirement. £24million has been repaid over the last two years with the over-borrowing position expected to reverse from 2015/16.

A7.4 The repayment policy was adjusted in 2013/14 in light of potential new Capital schemes increasing the CFR with a shift in emphasis for any repayment to be made on significant rises in PWLB rates providing advantageous rescheduling opportunities.

A7.5 The trigger for any repayment option will be considered when the payback period of the repayment penalty falls to two years in terms of net interest.

A7.6 The Capital Investment Plan remains fluid and the CFR in A7.1 includes £8.6million of temporary borrowing which may be replaced by other funding thereby reducing the CFR further.

A7.7 As a result of these factors and the continuing risks and costs in holding cash (section A8) the focus of the strategy switches back to early repaying borrowing to a target level of £10million over the next four years.

A7.8 The benefits of the strategy will be weighed against any resultant need for the Council to internally borrow cash resources to fund capital spending. At some point in the future the Council would have to re-borrow when these internal resources fell below operational cash flow requirements or borrowing reaches maturity, with potential exposure to higher rates.

A7.9 The current market conditions make repayment less attractive due to high penalty costs and these conditions are now forecast to continue further into 2015/16 (see section A5). Budget forecasts for 2014/15 have therefore not assumed the strategy aim to repay borrowing. However, the volatile conditions in the economic climate make predicting rate movements extremely difficult and Officers will act on this strategy at any point the rate environment moves to a favourable position.

A7.10 Based on current PWLB repayment terms, gilt yields need to rise by around 0.08% - 0.10% on the levels as at December 2013 for any repayment to be affordable and by 0.75% to reach the level at which the Council would ideally begin to make repayments.

A7.11 Any repayment of borrowing will only be applied following a thorough assessment of:

- any change to the level of the borrowing requirement
- additional capital projects funded from borrowing
- assessment of working capital and other Council cash backed resources such as Reserves, Provisions and capital grants
- prevailing market conditions
- anticipated cash flow and any temporary borrowing requirements
- future market expectations
- the need to re-borrow in the medium to longer term as loans reach maturity

A7.12 Rescheduling of existing debt will also be considered if opportunities arise, to supplement the primary aim of repaying loans.

A7.13 No new borrowing is envisaged for 2014/15. However, if in future years capital plans significantly change and there is a borrowing need based on internal cash levels, the Council may seek to secure new funding prior to the anticipated rise in borrowing rates in future years.

A7.14 The majority of the Council’s cost of interest and associated Revenue Provision relate to historic borrowing “supported” by central government and other debt transferred from Devon County Council on Local Government Reorganisation in 1998. (Borrowing is no longer fully supported due to reductions in Council grant) This supported borrowing along with prudential borrowing for capital resources which leads in most cases to an increase in the value of the Council’s own assets on its Balance Sheet.

A7.15 Borrowing from PWLB or other sources is only one option the Council has to finance its expenditure on capital projects e.g. the Council could use finance leases or provide financing via PFI agreements such as the Energy from Waste Plant.

A7.16 As a matter of policy approved borrowing sources are from the Public Works Loan Board and market instruments from counterparties listed by the Financial Services Authority. Local Authority Bonds will also be considered going forward but in the short term is unlikely to be progressed as the Council does not have a borrowing need.

A8 ANNUAL INVESTMENT STRATEGY

Investment Policy

A8.1 The Council's investment policy has regard to the CLG's Guidance on Local Government Investments and the CIPFA Treasury Management in Public Services Code of Practice.

A8.2 The Council's investment priorities, in line with CLG Guidance, are: -

the security of capital
the liquidity of its investments.

A8.3 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

A8.4 The borrowing of monies purely to invest or on-lend and make a return is unlawful and the Council will not engage in such activity.

A8.5 Annex 5 to this report details the policy for selection of counterparties and management of investments to achieve the objectives of the Investment Policy.

A8.6 Investment instruments identified for use in the financial year are listed at Annex 6 under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be set within the schedules accompanying the Council's Treasury Management Practices.

A8.7 In view of the difficult market conditions officers will continue to review alternative investment instruments for core cash. The Council is no longer considering loans to housing associations but the Mayor has asked officers to actively consider alternative options for loans or investments within Torbay.

A8.8 The Investment Strategy is based on current projected cash levels. If any significant changes occur to cash levels, e.g. strategy implementation of early repayment of PWLB borrowing, then the Investment Strategy will need to be reviewed.

A8.9 Any approved loan e.g. in local businesses driven by regeneration purposes will not form part of the Treasury Management strategy.

A8.10 If the Council wishes to invest in property for future rental streams this also will be dealt with outside of the Treasury management strategy, as a separate report to Council.

A8.11 The Council does not adopt a specific Ethical Investments policy but officers will have regard to any questionable activity on the part of a counterparty or sovereign government before depositing funds.

Investment Strategy

A8.12 The investment strategy for 2014/15 is strongly influenced by the market and credit risks outlined above but needs to be balanced with the need to maximise revenue within these risks.

A8.13 Expected investment levels at A4.1 subject to increasing risk. Suitable counterparties complying with the Council's selection policy are decreasing and enhanced rates previously available to Local Authorities have been scaled back or withdrawn completely in 2013/14 as a result of cheaper cash available through the Government's Funding for Lending scheme.

A8.14 Gives rise to strategy driver of using investment cash to repay borrowing (A7.6) to reduce exposure to the interest rate, market and credit risks.

A8.15 Given the forecast for static interest rates there is value in exposing an element of core cash levels to longer dated deposits to maximise returns in the short term subject to the creditworthiness policy.

A8.16 These will predominently be made with UK part-nationalised banks where the implicit government guarantee continues to offer the safest haven for Council cash. Duration will focus on one year deposits with these institutions to provide a maturity structure that allows officers to respond to reducing cash levels or significant changes in government stakeholding.

A8.17 Officers will also monitor the market for lending to other Local Authorities which is likely to offer better risk/return opportuinities for remaining core cash over the limited Bank counterparties available.

A8.18 A proportion of funds will be held in business reserve and notice accounts to ensure appropriate liquidity is maintained for normal cash flow purposes and strategy transactions (eg repayment of borrowing at short notice if PWLB rates move to a favourable position).

A8.19 The Fund Manager's strategy and performance will be subject to continuous monitoring and the CFO will vary the size of the holding in line with the aims of the overall strategy.

A9 Policy on the use of external advisors

A9.1 The Council currently appoints Capita Asset Services – Treasury Solutions (brand name changed from Sector Treasury Services in 2013) as its external treasury management advisor. The position is to be reviewed in 2014.

A9.2 The Council recognises the value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Chief Finance Officer will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented and subjected to regular review.

A9.3 The Council acknowledges that the responsibility for treasury management decisions remains with the Council at all times and will ensure that undue reliance is not placed upon the external advisors.

A10 Reporting Arrangements and Management Evaluation

A10.1 The Council will receive the following reports for 2014/15 as standard in line with the requirements of the Code of Practice:

- Annual Treasury Management Strategy report (this report)
- Mid-Year Treasury Review report
- Annual Treasury Outturn report

A10.2 The CFO will inform the Mayor/Executive Lead for Finance of any long-term borrowing/repayment undertaken or any significant events that may affect the Council's treasury management activities. The CFO will maintain a list of staff authorised to undertake treasury management transactions on behalf of the Council.

A10.3 The Chief Finance Officer is authorised to approve any movement between borrowing and other long-term liabilities within the Authorised Limit. Any such change will be reported to the next meeting of the Council.

A10.4 The impact of these policies will be reflected as part of the Council's revenue budget and therefore will be reported through the quarterly budget monitoring process.

A10.5 The Council's management and evaluation arrangements for Treasury Management are as follows:

- Monthly monitoring report to the Chief Finance Officer, Executive Lead for Finance, Director of Place & Resources and majority opposition Group
- Monthly meeting of the Treasury Manager/Chief Accountant to review previous months performance and plan following months activities
- Regular meetings with the Council's treasury advisors
- Annual meetings with the Council's appointed Fund Managers
- Membership and participation in the CIPFA Benchmarking Club
- The Audit Committee is the body responsible for scrutiny of Treasury Management.

A11 Other Matters

A11.1 **Loans to linked organisations**. The Chief Finance Officer, in conjunction with the Executive Lead for Finance, is authorised to agree loans to lend to “linked” organisations (such as Academy schools, housing associations, Council associate and subsidiary companies and NHS partners). As approved by Council in September 2012.

A11.2 **Advancing cash**. If approved the Council will advance cash to Torbay Council schools at a rate equivalent to that of the forecast investment yield (to reflect the lost investment opportunity), with the option of an additional 0.25% risk premium. The service will have to identify the funding for this advance from revenue or reserves in the year of the advance.

A11.3 **Investing cash for Local Payment Scheme (LPS) Schools.** If agreed by the Chief Finance Officer the Council will invest LPS school surplus balances on a temporary basis and endeavour to match Bank Rate on these investments on a variable basis. This will be for cash on a longer-term basis and will not apply to daily cash flow balances.

A11.4 **Soft Loans.** New Financial Instruments require the recognition of soft loans i.e. where a loan is made at a lower than ‘competitive’ rate the cost implicit in achieving the lower rate must be reflected in the Council’s accounts.

A11.5 **Anti-Money Laundering.** The Council will comply with all relevant regulations.

A11.6 **Intranet**. The Council’s treasury management procedures and other relevant documents can be accessed on the Council’s intranet site within the financial services pages.

Annex 1

Prudential & Treasury Management Indicators 2014/15 – 2017/18

Capital expenditure

This prudential indicator is a summary of the Council's capital expenditure plans (per the Capital Investment Plan Q2 2013/14 report).

Capital expenditure £M	*2012/13 Actual*	*2013/14 Estimate*	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Total	***23.6***	***24.6***	**23.3**	**10.2**	**5.0**	**0**

Capital Financing Requirement (CFR)

The CFR is the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need Based on historic expenditure. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely. The minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each asset's life.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £10M of such schemes within the CFR which could rise in 2014/15 if the Councils 17% share of the Energy from Waste liability is accounted for as an "on balance sheet" PFI scheme.

£m	2012/13 Actual	2013/14 Revised Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Capital Financing Requirement						
Total CFR	**136**	142	**146**	**150**	**150**	**145**
Movement in CFR	**(1)**	**6**	**4**	**4**	**0**	**(5)**
Movement in CFR represented by						
Net financing need for the year - capital	5	11	9	9	5	0
Less MRP/VRP and other financing movements	(6)	(5)	(5)	(5)	(5)	(5)
Movement in CFR	**(1)**	**6**	**4**	**4**	**0**	**(5)**

Temporary borrowing of up to £8.6million is included in the above CFR. Capital resources to this amount are expected and once confirmed will reduce the CFR by £8.6million.

<u>Gross Borrowing & Long term Liabilities and the Capital Financing Requirement</u>

In order to ensure that borrowing will only be for a capital purpose, the Council should ensure that gross external borrowing does not, except in the short term, exceed the total CFR.

£m	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
External Debt at 31 March						
External Borrowing	148	138	138	138	138	134
Other long-term liabilities (OLTL)	9	9	9	8	8	7
Total Borrowing and Other Long Term Liabilities	**157**	**147**	**147**	**146**	**146**	**141**
The Capital Financing Requirement	**136**	**142**	**146**	**150**	**150**	**145**
Excess of LTL>CFR	**(21)**	**(5)**	**(1)**	**4**	**4**	**4**

Affordability Prudential Indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

Ratio of financing costs to net revenue stream.

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

The ratio rises from 2014/15 due to expected substantial reductions in the Net Revenue Budget requirement measured against fixed costs of borrowing.

%	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Ratio	7.62	7.04	8.47	9.20	9.77	9.72

Incremental impact of capital investment decisions on council tax.

This indicator identifies the revenue costs associated with capital decisions as part of the next year's budget process. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

£	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Council tax - band D	0.00	0.00	0.00	0.00

The Council approved a 4- year Capital Investment Plan in 2013/14. There are no new schemes being presented for approval for 2014/15 and central government has removed supported borrowing. Therefore, there will be no new incremental increases to Council Tax.

However, if £8.6 million of temporary borrowing becomes permanent (expected capital receipts and grants are not confirmed) there will then be an incremental impact of £14 on the Torbay element of a Band D Council Tax.

Limits on Borrowing and Long-Term Liabilities

***The Operational Boundary*.** This is the limit beyond which external borrowing and long-term liabilities are not normally expected to exceed. In most cases, this would be linked to the CFR, but may be lower or higher depending on the levels of actual borrowing.

Operational boundary £m	2013/14 Current	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Borrowing	163	152	152	152	157
Long term liabilities	10	9	9	8	8
Total	173	161	161	160	165

***The Authorised Limit for external borrowing and long-term liabilities*.** A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external borrowing is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

Authorised limit £m	2013/14 Current	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Borrowing	182	172	176	177	182
Other long term liabilities	10	59	59	58	58
Total	192	231	235	235	240

Limits on Activity

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs/improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;

- Maturity structure of borrowing. These gross limits are set to reduce the Council’s exposure to large fixed rate sums falling due for refinancing and are required for upper and lower limits

Interest rate Exposures				
	2014/15 **Upper** **%**	**2015/16** **Upper** **%**	**2016/17** **Upper** **%**	**2017/18** **Upper** **%**
Limits on fixed interest rates:				
• Debt	100	100	100	100
• Investments	80	80	80	80
Limits on variable interest rates				
• Debt	20	20	30	30
• Investments	60	60	70	70

Maturity Structure of fixed interest rate borrowing 2014/15		
	Lower	**Upper**
Under 12 months	0%	5%
12 months to 2 years	0%	20%
2 years to 5 years	0%	20%
5 years to 10 years	0%	50%
10 years to 25 years	10%	100%
25 years to 40 years	10%	100%
Over 40 years	5%	80%

Investment Treasury Indicator and Limit

Total principal funds invested for greater than 364 days. These limits are set with regard to the Council’s liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end. The limits below allow for the external Fund Manager holding along with 50% of the in-house total to be fixed longer term.

Maximum principal sums invested for over 364 days					
£m	**2013/14**	**2014/15**	**2015/16**	**2016/17**	**2017/18**
Principal sums invested > 364 days	66	45	35	30	28

Policy on Minimum Revenue Provision for 2014/15

1. The Minimum Revenue Provision is a statutory charge that the Council is required to make from its revenue budget. This provision enables the Council to generate cash resources for the repayment of borrowing. The 2014/15 budget is £4.7 million.

2. The calculation of the provision is prescribed by legislation, which states that Councils are required to "determine for the current financial year an amount of MRP that it considers to be prudent" and prepare an annual statement on their MRP calculation to their full Council.

3. One of the aims of this legislation is to ensure that the repayment of principal owed for capital expenditure funded from unsupported borrowing is charged on a prudent basis which closely links to the asset's life. The provision for all assets, irrespective of asset life, for expenditure funded from supported borrowing and prudential borrowing prior to 2007/08 will continue to be charged at a minimum 4% per annum which is in line with central government's "support" for these costs within the Council's formula grant.

4. Torbay Council's Annual Minimum Revenue Provision Policy Statement states that the calculation of the MRP is as follows which has 2 stages:

   i) The Council will budget as a minimum for a provision of 4% of its capital financing requirement calculated as at 31st March of the preceding financial year. The capital financing requirement (CFR) is a calculation of a Council's "need to borrow" which is, in summary, the total of expenditure funded from borrowing less any repayments or similar previously made.

      To calculate the 4% provision the Council will use the "regulatory method" as identified in the Department of Communities and Local Government's (DCLG) Informal Commentary on the legislation.

      This calculation allows for the adjustments of the following items:

      - Deducting any expenditure and revenue provision made in relation to unsupported borrowing after 2007/08. The charge for unsupported borrowing after 2007/08 is calculated separately as described in paragraph ii below.
      - "Adjustment A" which relates to a previous calculation change in 2004
      - Adjustment of MRP to ensure no disadvantage results to Councils from the regulations compared to previous MRP regulations
      - Adjustment of MRP to ensure no disadvantage results to Councils from the requirements for accounting for Private Finance Initiative schemes

ii) For capital expenditure funded from unsupported or prudential borrowing less any repayment to date, the Council will make a provision based on the cumulative expenditure incurred on each asset in the previous financial years using a prudent asset life, which reflects the estimated usable life of that asset.

The Council will use the “asset life method” for the calculation, the MRP for each asset will be calculated using an annuity calculation based on the Council’s estimated pooled borrowing interest rate for the relevant year as detailed in the Treasury Management Strategy for that year. This will be adjusted for:-

- An adjustment to the MRP calculation will be made where there is expenditure in the previous financial year, but the asset is not yet operational. MRP will be calculated on the total expenditure on that asset in the year after the asset becomes operational.

5) Where relevant, the suggested asset lives for certain types of capitalised expenditure as detailed in the MRP guidance issued by DCLG will be used.

6) The Council will continue to charge services for their use of unsupported borrowing using a prudent asset life (or a shorter period) and an annuity calculation. Where possible the same asset life and borrowing interest rate will be used for both the charge to services and the calculation of the MRP.

7) In exceptional circumstances a Service may be allowed to extend the repayment period beyond the prudent asset life but this may be limited to the interest element. The increased revenue cost over the longer term will be a Service issue.

8) Where assets prior to 2007/08 have been purchased by unsupported borrowing (before the current legislation applied) and a MRP at 4% is provided for, the Council will aim, over the long term, to balance the annual costs of the MRP on these assets with the repayments made by services. This may result in a Voluntary Revenue Provision (VRP) or reserve transfer being made.

9) The Council will not change its existing “Adjustment A” calculation.

10) To mitigate any negative impact from the changes in accounting for leases and PFI schemes the Council will include in the annual MRP charge an amount equal to the amount that has been taken to the balance sheet to reduce the balance sheet liability for a PFI scheme or a finance lease. The calculation will be based on the annuity method using the Internal Rate of Return (IRR) implicit in the PFI or lease agreement.

11) In relation to borrowing transferred to the Council from Devon County Council for the Council’s share of the Devon County Council debt for local government reorganisation, the Council will budget to make a VRP over 40 years to ensure cash resources for the repayment of the debt is available on maturity.

Annex 3

Interest Rate Forecasts 2014 – 2017 (as at December 2013)

Capita Asset Services Interest Rate View	Now	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Capita Asset Services Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%
3 Month LIBID	0.39%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.60%	0.70%	0.90%	1.00%
6 Month LIBID	0.47%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.70%	0.80%	1.00%	1.20%	1.40%
12 Month LIBID	0.75%	0.80%	0.80%	0.80%	0.80%	0.80%	0.80%	0.80%	0.90%	1.00%	1.20%	1.40%	1.60%	1.80%	2.00%
5yr PWLB Rate	2.38%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%
10yr PWLB Rate	3.52%	3.70%	3.70%	3.70%	3.80%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%
25yr PWLB Rate	4.29%	4.40%	4.40%	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.20%
50yr PWLB Rate	4.33%	4.40%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.20%	5.20%	5.30%
Bank Rate															
Capita Asset Services	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%
UBS	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	-	-	-	-	-	-	-	-	-
Capital Economics	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	-	-	-	-	-
5yr PWLB Rate															
Capita Asset Services	2.38%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%
UBS	2.38%	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital Economics	2.38%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.50%	2.90%	3.30%	-	-	-	-	-
10yr PWLB Rate															
Capita Asset Services	3.52%	3.70%	3.70%	3.70%	3.80%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%
UBS	3.52%	3.90%	4.00%	4.00%	4.10%	4.10%	-	-	-	-	-	-	-	-	-
Capital Economics	3.52%	3.55%	3.55%	3.55%	3.55%	3.55%	3.55%	3.55%	3.55%	3.80%	-	-	-	-	-
25yr PWLB Rate															
Capita Asset Services	4.29%	4.40%	4.40%	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.20%
UBS	4.29%	4.40%	4.50%	4.50%	4.60%	4.60%	-	-	-	-	-	-	-	-	-
Capital Economics	4.29%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.35%	-	-	-	-	-
50yr PWLB Rate															
Capita Asset Services	4.33%	4.40%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.20%	5.20%	5.30%
UBS	4.33%	4.50%	4.50%	4.60%	4.60%	4.70%	-	-	-	-	-	-	-	-	-
Capital Economics	4.33%	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	4.50%	-	-	-	-	-

Appendix 4

Economic Background (provided by Capita on 2nd December 2013)

THE GLOBAL ECONOMY

The Eurozone (EZ). The sovereign debt crisis has eased during 2013 which has been a year of comparative calm after the hiatus of the Cyprus bailout in the spring. The EZ finally escaped from seven quarters of recession in quarter 2 of 2013 but growth is likely to remain weak and so will dampen UK growth. The ECB's pledge to buy unlimited amounts of bonds of countries which ask for a bail out, has provided heavily indebted countries with a strong defence against market forces. This has bought them time to make progress with their economies to return to growth or to reduce the degree of recession. However, debt to GDP ratios (2012 figures) of 176% Greece, Italy 131%, Portugal 124%, Ireland 123% and Cyprus 110%, remain a cause of concern, especially as many of these countries are experiencing continuing rates of increase in debt in excess of their rate of economic growth i.e. these debt ratios are continuing to deteriorate. Any sharp downturn in economic growth would make these countries particularly vulnerable to a new bout of sovereign debt crisis. It should also be noted that Italy has the third biggest debt mountain in the world behind Japan and the US. Greece remains particularly vulnerable and continues to struggle to meet EZ targets for fiscal correction. Many commentators still view a Greek exit from the Euro as inevitable and there are concerns that austerity measures in Cyprus could also end up in forcing an exit. The question remains as to how much damage an exit by one country would do and whether contagion would spread to other countries. However, the longer a Greek exit is delayed, the less are likely to be the repercussions beyond Greece on other countries and on EU banks. It looks increasingly likely that Slovenia will be the next country to need a bailout.

Sentiment in financial markets has improved considerably during 2013 as a result of firm Eurozone commitment to support struggling countries and to keep the Eurozone intact. However, the foundations to this current "solution" to the Eurozone debt crisis are still weak and events could easily conspire to put this into reverse. There are particular concerns as to whether democratically elected governments will lose the support of electorates suffering under EZ imposed austerity programmes, especially in countries like Greece and Spain which have unemployment rates of over 26% and unemployment among younger people of over 50%. The Italian political situation is also fraught with difficulties in maintaining a viable coalition which will implement an EZ imposed austerity programme and undertake overdue reforms to government and the economy.

USA. The economy has managed to return to reasonable growth in Q2 2013 of 2.5% y/y and 2.8% in Q3, in spite of the fiscal cliff induced sharp cuts in federal expenditure that kicked in on 1 March, and increases in taxation. The Federal Reserve has continued to provide huge stimulus to the economy through its $85bn per month asset purchases programme of quantitative easing. However, it is expected that this level of support will start to be tapered down early in 2014. It has also pledged not to increase the central rate until unemployment falls to 6.5%; this is probably unlikely to happen until early 2015. Consumer, investor and business confidence levels have improved markedly in 2013. The housing market has turned a corner and house sales and increases in house prices have returned to healthy levels. Many house owners have, therefore, been helped to escape from negative equity and banks have also largely repaired their damaged balance sheets so that they can resume healthy levels of lending. All this portends well for a reasonable growth rate looking forward.

China. Concerns that Chinese growth could be heading downwards have been allayed by recent stronger statistics. There are still concerns around an unbalanced economy which is heavily dependent on new investment expenditure, and for a potential bubble in the property sector to burst, as it did in Japan in the 1990s, with its consequent impact on the financial health of the banking sector. There are also increasing concerns around the potential size, and dubious creditworthiness, of some bank lending to local government organisations and major corporates. This primarily occurred during the government promoted expansion of credit, which was aimed at protecting the overall rate of growth in the economy after the Lehman's crisis.

Japan. The initial euphoria generated by "Abenomics", the huge QE operation instituted by the Japanese government to buy Japanese debt, has tempered as the follow through of measures to reform the financial system and the introduction of other economic reforms, appears to have stalled. However, at long last, Japan has seen a return to reasonable growth and positive inflation during 2013 which augurs well for the hopes that Japan can escape from the bog of stagnation and deflation and so help to support world growth. The fiscal challenges though are huge; the gross debt to GDP ratio is about 245% in 2013 while the government is currently running an annual fiscal deficit of around 50% of total government expenditure. Within two years, the central bank will end up purchasing about Y190 trillion (£1,200 billion) of government debt. In addition, the population is ageing due to a low birth rate and will fall from 128m to 100m by 2050.

THE UK ECONOMY

Economic growth. Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth stongly rebounded in 2013 - quarter 1 (+0.3%), 2 (+0.7%) and 3 (+0.8%), to surpass all expectations as all three main sectors, services, manufacturing and construction contributed to this strong upturn. The Bank of England has, therefore, upgraded growth forecasts in the August and November quarterly Inflation Reports for 2013 from 1.2% to 1.6% and for 2014 from 1.7% to 2.8%, (2015 unchanged at 2.3%). The November Report stated that: -

> *In the United Kingdom, recovery has finally taken hold. The economy is growing robustly as lifting uncertainty and thawing credit conditions start to unlock pent-up demand. But significant headwinds — both at home and abroad — remain, and there is a long way to go before the aftermath of the financial crisis has cleared and economic conditions normalise. That underpins the MPC's intention to maintain the exceptionally stimulative stance of monetary policy until there has been a substantial reduction in the degree of economic slack. The pace at which that slack is eroded, and the durability of the recovery, will depend on the extent to which productivity picks up alongside demand. Productivity growth has risen in recent quarters, although unemployment has fallen by slightly more than expected on the back of strong output growth.*

So very encouraging - yes, but, still a long way to go! However, growth is expected to be strong for the immediate future. One downside is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have ameliorated this to some extent. A rebalancing of the economy towards exports has started but as 40% of UK exports go to the Eurozone, the difficulties in this area are likely to continue to dampen UK growth.

Forward guidance. The Bank of England issued forward guidance in August which said that the Bank will not start to consider raising interest rates until the jobless rate (Labour Force Survey / ILO i.e. not the claimant count measure) has fallen to 7% or below. This would require the creation of about 750,000 jobs and was forecast to take three years in August, but revised to possibly quarter 4 2014 in November. The UK unemployment rate currently stands at 2.5 million i.e. 7.6 % on the LFS / ILO measure. The Bank's guidance is subject to three provisos, mainly around inflation; breaching any of them would sever the link between interest rates and unemployment levels. This actually makes forecasting Bank Rate much more complex given the lack of available reliable forecasts by economists over a three year plus horizon. The recession since 2007 was notable for how unemployment did NOT rise to the levels that would normally be expected in a major recession and the August Inflation Report noted that productivity had sunk to 2005 levels. There has, therefore, been a significant level of retention of labour, which will mean that a significant amount of GDP growth can be accommodated without a major reduction in unemployment.

Credit conditions. While Bank Rate has remained unchanged at 0.5% and quantitative easing has remained unchanged at £375bn in 2013, the Funding for Lending Scheme (FLS), aimed at encouraging banks to expand lending to small and medium size enterprises, has been extended. The FLS certainly seems to be having a positive effect in terms of encouraging house purchases (though levels are still far below the pre-crisis level), FLS is also due to be bolstered by the second phase of Help to Buy aimed at supporting the purchase of second hand properties, which is now due to start in earnest in January 2014. While there have been concerns that these schemes are creating a bubble in the housing market, the house price increases outside of London and the south-east have been minimal. However, bank lending to small and medium enterprises continues to remain weak and inhibited by banks still repairing their balance sheets and anticipating tightening of regulatory requirements.

Inflation. Inflation has fallen from a peak of 3.1% in June 2013 to 2.2% in October. It is expected to fall back to reach the 2% target level within the MPC's two year time horizon.

AAA rating. The loss of the UK's AAA rating from Fitch (April 2013) and Moody's (February 2013) has caused little market reaction.

Capita Asset Services forward view

Economic forecasting remains difficult with so many external influences weighing on the UK. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, and safer bonds.

There could well be volatility in gilt yields over the next year as financial markets await the long expected start of tapering of asset purchases by the Fed. The timing and degree of tapering could have a significant effect on both Treasury and gilt yields. Equally, at the time of writing, the political deadlock and infighting between Democrats and Republicans over the budget, and the raising of the debt limit, has only been kicked down the road, rather than resolved. Resolving these issues could have a significant effect on gilt yields during 2014.

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 of bond issuance in other major western countries. Increasing investor confidence in economic recovery is also likely to compound this effect as a continuation of recovery will further encourage investors to switch back from bonds to equities.

Creditworthiness Policy

1. This Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utlilising credit ratings from the three main credit rating agencies - Fitch, Moodys and Standard and Poors. The credit ratings are supplemented by with the following overlays:

    - Credit watches and credit outlooks from the credit rating agencies
    - Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings
    - Sovereign ratings to select counterparties from only the most creditworthy countries

2. This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of Credit Default Swap (CDS) spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. The Chief Finance Officer applies and reviews suitable financial and durational limits to each of these bands.

3. The Capita creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

4. All credit ratings will be monitored on a weekly basis. The Council is alerted to changes to ratings of all three agencies through its use of the Capita creditworthiness service and the CFO will vary the approved lending list as appropriate to these changes.

    - if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
    - in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

5. The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA+.The list of countries that qualify using this credit criteria as at the date of this report are shown below and this list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

AAA		AA+
Australia	Luxembourg	Hong Kong
Canada	Norway	Netherlands
Denmark	Singapore	United Kingdom
Finland	Sweden	USA
Germany	Switzerland	

6. Sole reliance will not be placed on the use of this external service. In addition the CFO will also use market data and market information, information on government support for banks and the credit ratings of that government support.

7. The Council uses an external fund manager to manage a proportion of the investment portfolio available to offset the borrowing requirement. The use of an external fund manager allows the Council to spread its treasury risk in relation to type of investment, investment counterparties and manager opinion.

8. The external fund manager will comply with the Annual Investment Strategy. The agreement between the Council and the fund manager additionally stipulates guidelines and duration and other limits in order to contain and control risk.

9. The fund manager mandate allows for additional amounts to be placed and the CFO will exercise this option if this is deemed to be in the best interests of the Council up to a limit of 35% of the total portfolio. As Council’s cash investment reduce it is likely the Fund Manager holding will be correspondingly decreased. The Council retains the right to withdraw all or part of the fund at seven days notice.

Specified and Non-Specified Investments

Investments types recorded in bold type are the instruments most commonly used by the in-house team.

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum ‘high’ quality criteria where applicable.

	Minimum ‘High’ Credit Criteria	Use
Debt Management Agency Deposit Facility	--	In-house
Term deposits – local authorities and other public sector bodies	--	In-house
Term deposits – banks and building societies	Creditworthiness system colour band “Green”	In-house and Fund Manager
UK nationalised/part-nationalised banks	--	In-house and Fund Manager
Banks part-nationalised by high credit rated (sovereign rating) countries – non UK	Sovereign rating AA+	In-house and Fund Manager
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): - 1. Government Liquidity Funds 2. Money Market Funds	AAA	In-house and Fund Manager

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the Specified Investment criteria.

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

The maturity limits recomended will not be exceeded. Under the delegated powers the Chief Finance Officer can set limits that are lower based on the latest economic conditions and credit ratings.

Investment Type	**Minimum Credit Criteria**	**Use**	**Max % of total investments**	**Max. maturity period ***
UK nationalised/part-nationalised banks (maturities over one year)	**Sovereign rating AA+**	**In-house and Fund Manager**	**50%**	**3 years**
Term deposits (over one year) – local authorities and other public sector bodies	**--**	**In-house**	**50%**	**5 years**
Term deposits (over one year) – banks and building societies	**Creditworthiness system colour band "Purple"**	**In-house and Fund Manager**	**75%**	**2 years**
Collateralised deposit	See note 1	In-house	20%	5 years
Certificates of deposits issued by banks and building societies (maturities under one year)	Creditworthiness system colour band "Green"	In-house and Fund Manager	50%	1 year
Certificates of deposits issued by banks and building societies (maturities over one year)	Creditworthiness system colour band "Purple"	In-house and Fund Manager	50%	1 year
UK Government Gilts/Treasury Bills	Sovereign rating AA+	In-house and Fund Manager	100%	5 years

Investment Type	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period*
Bonds issued by multilateral development banks	AA+	In-house and Fund Manager	50%	5 years
Sovereign bond issues (other than the UK govt)	Sovereign rating AA+	In-house and Fund Manager	50%	5 years
Structured Deposits	**Creditworthiness system colour band "Orange" <1 year "Purple" >1 year**	**In-House**	**25%**	**2 years**
Term deposits with unrated counterparties with unconditional guarantee from HMG or credit-rated parent institution. Specific counterparty to be approved by CFO	Sovereign rating (guarantor) Sovereign AA+ or Creditworthiness system colour band "Red"	In-house and Fund Manager	20%	1 year
Commercial paper issuance by UK banks covered by UK Government guarantee	Sovereign rating AA+	Fund Manager	35%	5 years
Commercial paper other	Creditworthiness system colour band "Red"	Fund Manager	35%	5 years
Floating Rate Notes	Long-term AA	In-house and Fund Manager	35%	5 years
Property Fund: *the use of these investments would constitute capital expenditure*	--	In-house and Fund Manager	35%	5 years

Investment Type	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period*
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs):- 1.Bond Funds 2.Gilt Funds	AAA	Fund Manager	35%	5 years
Corporate Bonds	AA	In-house and Fund Manager	35%	5 years
Other debt issuance by UK Banks covered by UK Government guarantee	Sovereign rating AA+	In-house and Fund Manager	35%	5 years

*Of which in any class of investment:

- 10% maximum 3 years (or over)
- 25% maximum 2 to 3 years

Notes

1. As collateralised deposits are backed by collateral of AAA rated local authority LOBOs, this investment instrument is regarded as being a AAA rated investment as it is equivalent to lending to a local authority.