AUD047
FOR DECISION
WARD(S): GENERAL

AUDIT COMMITTEE

4 December 2012

TREASURY MANAGEMENT MID-YEAR REVIEW 2012/13

REPORT OF HEAD OF FINANCE

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RECENT REFERENCES:

CAB2284 – Treasury Management Strategy 2012/13, 13 February 2012

AUD038 – Treasury Management Stewardship Report 2011/12, 25 Sept. 2012

CAB2378 – Capital Strategy and Programme 2012/13 – 2015/16 12 Sept 2012

CAB2386(HSG) – HRA 2012/13 Revised Budget 19 Sept 2012

EXECUTIVE SUMMARY:

The Treasury Management Strategy for 2012/13 (CAB2284) has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year.

The Code also recommends that members are informed of treasury management activities at least twice a year. This report therefore ensures that the Council is embracing Best Practice in accordance with CIPFA's recommendations.

Treasury management is defined as:
"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

RECOMMENDATIONS:

That the Audit Committee:

1. Approves the Treasury Management Mid-Year Monitoring Report for 2012/13, and
2. Notes the updated Prudential Indicators provided at Appendix A.

AUDIT COMMITTEE

4 December 2012

TREASURY MANAGEMENT MID-YEAR REVIEW 2012/13

1 Introduction

1.1 The Treasury Management Strategy for 2012/13 (CAB2284) has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year.

1.2 The Code also recommends that members are informed of Treasury Management activities at least twice a year. This report therefore ensures the Council is embracing Best Practice in accordance with CIPFA's recommendations.

1.3 Treasury management is defined by the CIPFA Code of Practice on Treasury Management as:

> "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2 Economic Background

2.1 Growth: The world economy faced yet another soft patch. The UK and the Eurozone (with the exception of Germany) struggled to show discernible growth whilst the US economy grew slowly. UK GDP contracted by 0.3% in the first calendar quarter of 2012 and by 0.4% in second, reflecting the difficult economic conditions faced by businesses and consumers domestically and globally. Businesses were more inclined to take defensive strategies involving cost cutting rather than increasing capital spending. Financial conditions facing households continued to be weak as wage growth remained subdued and was, for much of the period, outstripped by inflation. Much of the fall in Q2 GDP could probably be attributed to the impact of the additional bank holiday for the Diamond Jubilee, and could be recovered in Q3.

2.2 Inflation: Inflation, which had remained stubbornly sticky throughout 2011, slowly began to fall. Annual CPI dipped below 3% for the first time in two and half years in May and fell to the lowest level since November 2009 in June, with a reading of 2.4%. It ticked up marginally to 2.5% by August. Although the recent rise in commodity prices has been worrying, the rise in oil and food prices – the latter mainly due to poor weather-related yields - are well below the spikes of 2010-11.

2.3 The lack of growth and the fall in inflation were persuasive enough for the Bank of England to sanction £50 billion asset purchases (QE) in July, taking total QE to £375 billion. The possibility of a rate cut from the current level of 0.5% was discussed at the Bank's Monetary Policy Committee meetings in June and July; however reference to it was subsequently dropped suggesting that this policy option had left the table for the immediate future. The Government's Funding for Lending (FLS) initiative, intended to lower banks' funding costs, commenced in August. The Bank of England will assess its effects in easing the flow of credit before committing to further policy action.

2.4 Gilt yields and money market rates: Gilt yields fell sharply raising the prospect that very short-dated yields could turn negative. 2-year yields fell to 0.06%, 5-year yields to 0.48% and 10-year yields to 1.45%. Despite the likelihood the DMO (Debt Management Office) would revise up its gilt issuance for 2012/13, there were several gilt-supportive factors: the Bank of England's continued purchases of gilts under an extended QE programme; investors preferring the safer haven of UK government bonds to those of European sovereigns; the coalition's commitment to fiscal discipline by sticking to its "plan A" for deficit reduction; large scale purchases by banks to comply with the FSA's liquidity buffer requirements; and general risk aversion against a weak economic backdrop. PWLB (Public Works Loans Board) borrowing rates fell commensurately (the Board maintained the +0.90% margin above the equivalent gilt yield for new borrowing). Money market rates fell over the six month period by between 0.2% to 0.6% for 1-12 month maturities.

3 <u>Debt Management</u>

	Balance on 01/04/2012 £Ms	Debt Maturing £Ms	Debt Repaid £Ms	New Borrowing £Ms	Balance on 30/09/2012 £Ms	Increase/ Decrease in Borrowing £Ms
Short Term Borrowing	0.0	0.0	0.0	0.0	0.0	0.0
Long Term Borrowing	156.7	0.0	0.0	0.0	156.7	0.0
TOTAL BORROWING	**156.7**	**0.0**	**0.0**	**0.0**	**156.7**	**0.0**
Weighted Average Rate %	3.30%				3.30%	
Average Life Years	25 yrs				25 yrs	

3.1 PWLB Borrowing: The PWLB remains an attractive source of borrowing for the Council as it offers flexibility and control. The large downward move in gilt yields in the second quarter resulted in PWLB rates falling across all maturities.

3.2 In August HM Treasury announced details of the "Certainty Rate" which will enable "eligible authorities" to access cheaper PWLB funding, with a 20 basis point reduction on the standard PWLB borrowing rate. Initially announced in the March 2012 Budget, HM Treasury have introduced this initiative to incentivise local authorities to provide robust forecasts on borrowing plans. This rate was introduced in November 2012.

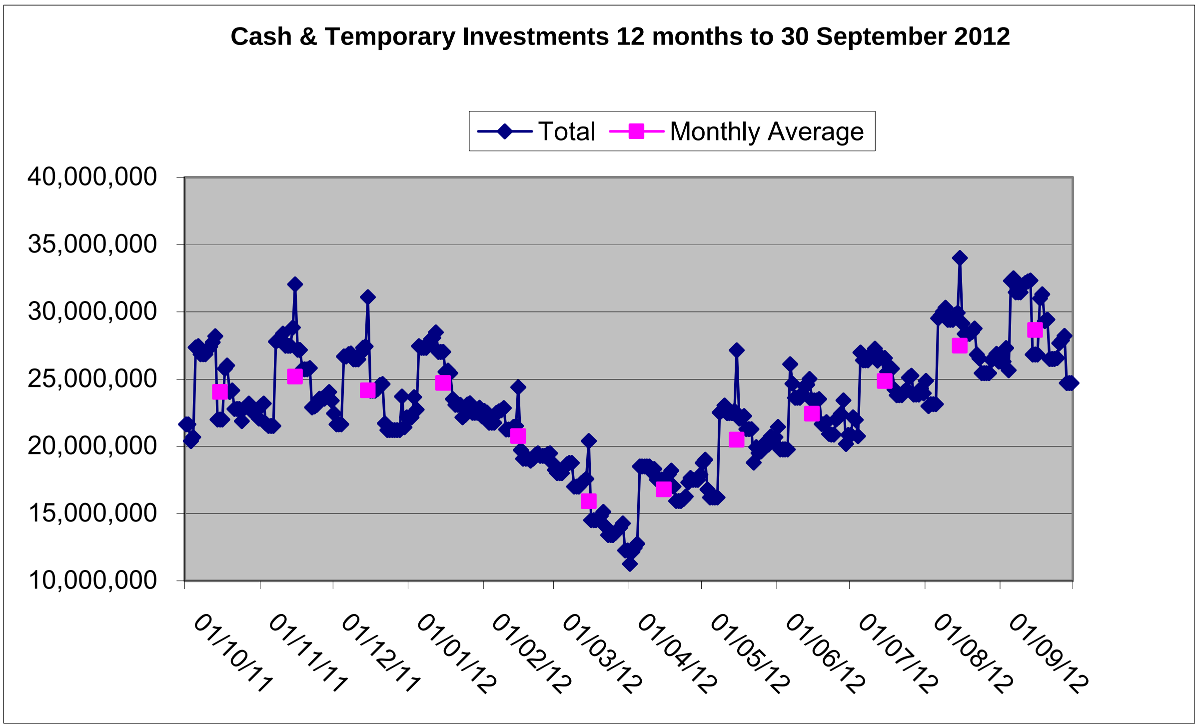
3.3 The Council completed the pro-forma projecting the Council's planned borrowing requirements over a three year period and returned it to CLG by the deadline of 17th September 2012.

3.4 Alternative borrowing sources: Whilst there are several claims that a competitive, comparable equivalent to long-dated PWLB borrowing is readily available, the Council will continue to adopt a cautious and considered approach to funding from the capital markets.

3.5 For the Council the use of internal resources in lieu of borrowing has continued to be the most cost effective means of funding its forecast £9.3m of capital expenditure not funded from reserves. This has lowered overall treasury risk by reducing both external debt and temporary investments. This position is expected to be maintained through out the horizon of this report, 2014/15, due to slippage of the capital programme.

4 Investment Activity

4.1 The Guidance on Local Government Investments gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles. The daily balances held are shown below:



4.2 Investment activity was as follows:

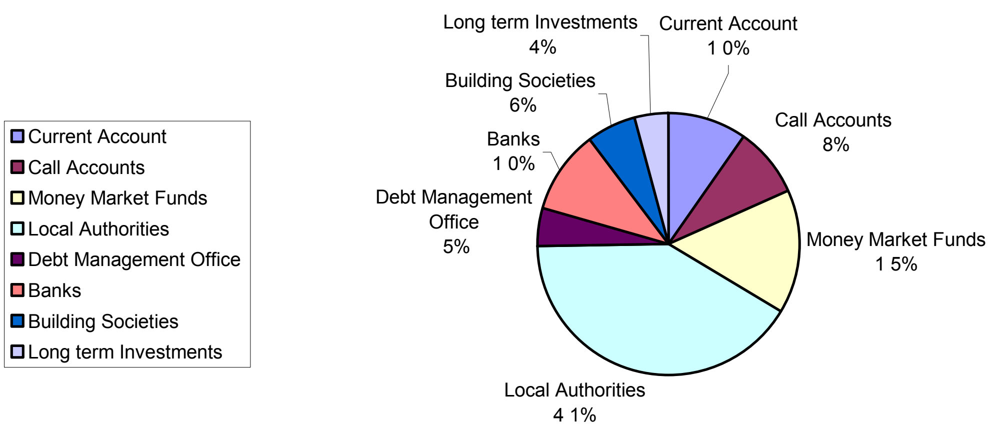
	Balance on 01/04/2012 £000s	Investments Made £000s	Investments Repaid £000s	Balance on 30/09/2012 £000's	Increase/ (decrease) in Investments £000's
Short Term Investments					
Call Accounts	0	6,000	3,000	3,000	3,000
Pooled Funds	1,750	20,700	19,150	3,300	1,550
Term Deposits					
Local Authorities	9,000	18,000	14,000	13,000	4,000
Debt Management Office	500	26,500	27,000	0	(500)
Banks	0	11,000	8,000	3,000	3,000
Building Societies	0	8,000	8,000	0	0
Long Term Investments	1,000	0	0	1,000	0
TOTAL INVESTMENTS	12,250	90,200	79,150	23,300	11,050

Other Interest Bearing	Balance on 01/04/2011 £000s	Cash Received £000s	Cash Paid £000s	Balance on 31/03/2012 £000's	Increase/ (decrease) in Balance £000's
Current Account	1,024	182,672	181,290	2,406	1,382
Total External Balances *	13,274	103,522	91,090	25,706	12,432

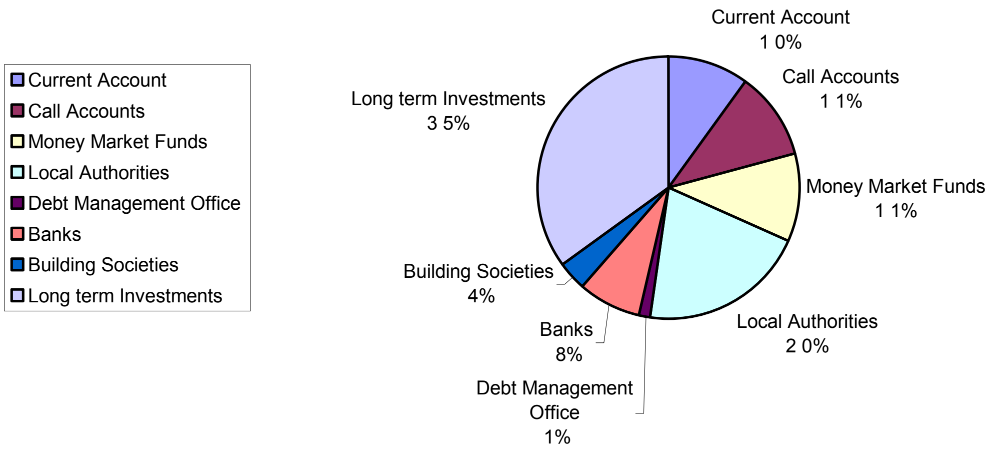
* Cash Received excludes investments repaid, Cash Paid excludes investments made

4.3 Analyses of average balances & interest receivable for the 6 months to September 2012

Average Investment per Sector



% Income per Sector



4.4 Security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2012/13 CAB2284. New investments can be made with the institutions/instruments as set down on the approved counterparty criteria in Appendix B.

4.5 Additionally, on consulting with the Council's treasury management advisors Arlingclose, counterparties can have their deposit durations shortened and even be suspended entirely from the counterparty list depending on the state of the market.

4.6 Following the decision to shorten deposit durations with investment counterparties in May this year, the Council later extended the duration of deposits in late July. The move to extend duration was as a result of monitoring economic and political developments in the UK, Europe and globally. The various risk metrics used to assess the creditworthiness of financial institutions had shown continued signs of stabilisation, and in some cases, considerable improvement.

4.7 At this time of extending duration limits with UK, Australian, Canadian and American banks, the Council also re-introduced the strongest banks in the stronger European sovereigns onto its approved lending list.

4.8 Counterparty credit quality is demonstrated by the Credit Score Analysis summarised below. The credit scores are based on the Council's quarter-end investment position.

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating	Time Weighted Average – Credit Risk Score	Time Weighted Average – Credit Rating
30/09/2011	2.96	AA	2.81	AA
30/12/2011	3.02	AA	3.12	AA
31/03/2012	1.92	AA+	1.69	AA+
30/06/2012	3.23	AA	1.59	AA+
30/09/2012	2.82	AA	1.89	AA+

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
- D = lowest credit quality = 15
-Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

4.9 Maturities for new investments with financial institutions on the Council's list are currently as follows:

a) UK Institutions

(i) Lloyds TSB, Bank of Scotland and National Westminster Bank and Royal Bank of Scotland for a maximum period of 6 Months, and

(ii) Barclays, Nationwide Building Society, HSBC Bank and Standard Chartered for a maximum period of 12 months.

b) Non-UK Institutions

(i) Approved Australian and Canadian banks for a maximum period of 12 months;

(ii) JP Morgan Chase Bank for a maximum period of 12 months;

(iii) Bank Nederlandse Gemeenten N.V., Deutsche Bank AG, Nordea Bank, Rabobank and Svenska Handelsbanken for a maximum period of 12 months, and

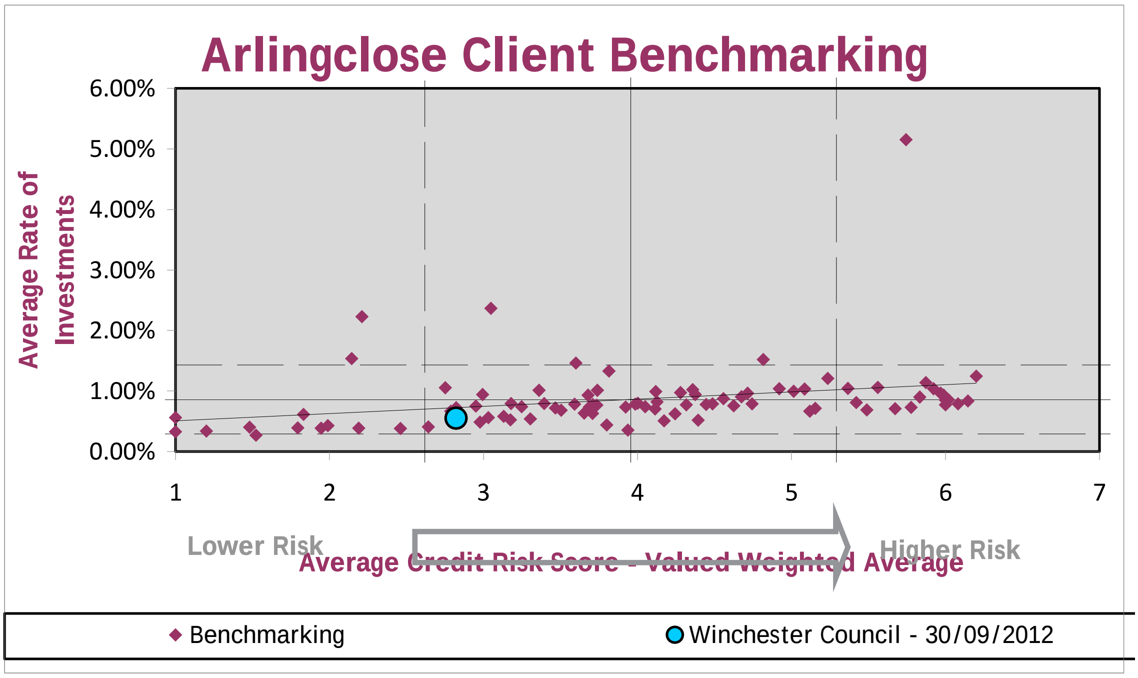
(iv) BNP Paribas,Credit Agricole CIB,Credit Agricole SA, Societe Generale and ING Bank for a maximum period of 100 days.

4.10 Safe Custody Arrangements

a) The Council opened a custody account with King & Shaxson in September 2012. By opening a custody account the Council now has the ability to use a number of approved investment instruments, as outlined in the 2012/13 Treasury Strategy (CAB2284) in order to diversify the investment portfolio. Investment instruments requiring a custodian facility include Treasury Bills, Certificates of Deposit, Gilts, Bonds and Supranational Bonds.

b) By establishing custody arrangements, the Council will be better-placed to consider the use of alternative investment instruments in response to evolving credit conditions.

4.11 The Council's average credit risk score at 30 September 2012 is relatively low when compared with other Arlingclose - local authority clients meaning that the Council has a portfolio that is more risk averse.



The Head of Finance can report that the investment portfolio has been managed within the counterparty limits set by the Council in the Treasury Management Strategy.

4.12 Budgeted Interest Income and performance in the year to 30 September 2012:-

a) The Council's budgeted interest income for the year has been set at £67,000 at an average rate of 0.5%. The average cash balances representing the Council's reserves, working balances, were budgeted at £15.4m during the period. Actual average balances for the 6 month period were £24.6m caused mainly by the impact of Housing Finance Reform.

b) The UK Bank Base Rate has been maintained at 0.5% since March 2009 and is not forecast to rise until 2015/16. Short-term money market rates have remained at very low levels. The Council has interest receivable of £97,000 to the 30 September 2012 and anticipates an interest outturn of circa £180,000 / 0.72% for the whole year.

5 Other Holdings

5.1 Local Authorities Mutual Investment Trust (LAMIT)

a) The Council currently holds 422,654 units in the LAMIT property fund which were purchased in 1989/90 at a cost price of £1 million. The value of LAMIT has been subject to market fluctuations.

Valuation date	Value*	Gain / (Loss) on investment (unrealised)
31st March 2009	821,000	(179,000)
31st March 2010	913,000	(87,000)
31st March 2011	962,000	(38,000)
31st March 2012	963,000	(37,000)
30th September 2012	972,000	(28,000)

b) In accordance with the accounting requirements an impairment was reflected in the Accounts to 31 March 2012. The effect of the improved valuation will allow a reversal of £9k of this charge in the year to September.

c) Dividends receivable on this investment in the 6 months to September amounted to £34,008 (6.8%).

6 Heritable Bank in Administration

6.1 The Council had an investment of £1m with Heritable Bank Ltd which was placed into administration in October 2008. Whilst in Administration, the Administrators will be seeking to find purchasers for, and will continue to manage, the remainder of Heritable's business and loan book to maximise recovery for creditors. At 30 September 2012 the Council had received dividends of £748,194 with a further £70,000 forecast to be received this year. It is currently forecast that 86p-90p/£ will be recovered overall.

7 Compliance with Prudential Indicators

7.1 The Head of Finance can confirm that the Council has complied with its Prudential Indicators for 2012/13 that were set as part of the Council's Treasury Management Strategy (CAB2284).

7.2 Members are asked to note the performance against the indicators as detailed in Appendix A.

8 Outlook for the remainder of the year

8.1 At the time of writing this activity report in September 2012, economic growth remains elusive. Tight credit conditions and weak earnings growth are constraining consumer and corporate spending. The outlook is for official interest rates to remain low for an extended period, as shown below.

	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
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
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	-0.25

OTHER CONSIDERATIONS:

9 SUSTAINABLE COMMUNITY STRATEGY AND CHANGE PLANS (RELEVANCE TO):

9.1 The Treasury Management Strategy supports all tenets of the Community Strategy including the core value of being efficient and ensuring value for money.

10 RESOURCE IMPLICATIONS:

10.1 Interest payable:-

a) Housing Finance Reform, loans totalling £156.7m at a weighted average fixed rate of 3.30%. Annual interest cost is £5.20m. No capital repayments are due for 10.5 years. If the £5m loan due in 2023 was to be refinanced for a further 11 years an additional interest cost of £0.01m would be incurred, at current interest rates.

b) Embedded lease interest costs (in relation to the Environmental Services Contract) are at a fixed rate of 2.16% total £49k in 2012-13.

10.2 The Original Estimate for Interest Receivable in 2012/13 was £67,000. The current forecast is £180,000 which is caused by higher balances being brought forward from 2011/12 due to slower than planned spending of the capital programme and higher than budgeted balances being generated by the Housing Revenue Account.

10.3 Interest sensitivity on a forecast average balance for the year of £25.5m is +/- 0.25% = £64,000.

11 RISK MANAGEMENT ISSUES

11.1 These are considered within the report.

BACKGROUND DOCUMENTS:

APPENDICES:

Appendix A Prudential Indicators

Appendix B Counterparty Criteria

Appendix C Investments at 30 September 2012

Appendix D Glossary of Terms

PRUDENTIAL INDICATORS

Capital Financing Requirement

Estimates of the Council's cumulative maximum external borrowing requirement for 2011/12 to 2014/15 are shown in the table below:

	31/03/2012 Actual £000s	31/03/2013 Estimate £000s	31/03/2014 Estimate £000s	31/03/2015 Estimate £000s
Capital Financing Requirement	164,508	173,468	177,862	177,173
Less: Existing Profile of Borrowing	156,722	156,722	156,722	156,722
Less: Other Long Term Liabilities	2,409	2,088	1,767	1,446
Cumulative Maximum External Borrowing Requirement	**5,377**	**14,658**	**19,373**	**19,005**

Balances and Reserves

Estimates of the Council's level of Balances and Reserves for 2011/12 to 2014/15 are as follows:

	31/03/2012 Actual £000s	31/03/2013 Estimate £000s	31/03/2014 Estimate £000s	31/03/2015 Estimate £000s
Balances and Reserves	19,254	25,320	18,279	18,133

Prudential Indicator Compliance

a) Authorised Limit and Operational Boundary for External Debt

* *The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached.*

* The Council's Affordable Borrowing Limit was set at £188.3m for 2012/13.

* *The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit.*

* The Operational Boundary for 2012/13 was set at £181.3m.

* The Head of Finance confirms that there were no breaches to the Authorised Limit or the Operational Boundary during the year and there has been no borrowing or use of the overdraft facility to the 30 September 2012.

(b) Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

* *These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.*

PRUDENTIAL INDICATORS

** The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.*

	Limits for 2012/13 £ / %
Upper Limit for Fixed Rate Exposure	100%
Compliance with Limits:	Yes
Upper Limit for Variable Rate Exposure for Debt	20%
Compliance with Limits:	Yes
Upper Limit for Variable Rate Exposure for Investments	100%
Compliance with Limits:	Yes

Interest Rate Exposures	**Actual at 31/03/12 %**	**2012/13 Approved %**	**Actual at 30/09/12 %**
<u>Fixed</u>			
Upper Limit for Fixed Interest Rate Exposure on Debt	100	100	100
Upper Limit for Fixed Interest Rate Exposure on Investments	0	0	0
Net Fixed Exposure	**100**	**100**	**100**
<u>Variable</u>			
Upper Limit for Variable Interest Rate Exposure on Debt	0	20	0
Upper Limit for Variable Interest Rate Exposure on Investments	100	100	100
Net Variable Exposure	**0**	**64**	**0**

PRUDENTIAL INDICATORS

c) Maturity Structure of Fixed Rate Borrowing

** This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.*

Maturity Structure of Fixed Rate Borrowing	Upper Limit £m	Lower Limit £m	Actual Fixed Rate Borrowing as at 30/09/12 £m	% Fixed Rate Borrowing as at 30/09/12	Compliance with Set Limits?
Under 12 months	20.0	0.0	0.0	0.0%	Yes
12 months and within 24 months	40.0	0.0	0.0	0.0%	Yes
24 months and within 5 years	60.0	0.0	0.0	0.0%	Yes
5 years and within 10 years	120.0	0.0	0.0	0.0%	Yes
10 years and within 20 years	183.3	0.0	65.0	41.5%	Yes
20 years and within 30 years	183.3	0.0	35.0	22.3%	Yes
30 years and within 40 years	183.3	0.0	20.0	12.8%	Yes
40 years and within 50 years	183.3	0.0	36.7	23.4%	Yes
50 years and above	183.3	0.0	0.0	0.0%	Yes

d) Gross and Net Debt

The purpose of this treasury indicator is to highlight if there is a situation where the Authority is planning to borrow in advance of need.

Upper Limit on Net Debt compared to Gross Debt	2011/12 Actual £m	2012/13 Estimate £m	Compliance with Set Limits?
Outstanding Borrowing (at nominal value)	156.7	156.7	**Yes**
Other Long-term Liabilities (at nominal value)	2.4	2.1	**Yes**
Gross Debt	159.1	158.8	**Yes**
Less: Investments	13.3	10.7	
Net Debt	**145.8**	**148.1**	

e) Net Debt and Capital Financing Requirement

- This is a key indicator of prudence. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Authority should ensure that the net external borrowing does not, except in the short term, exceed the total of the Capital Financing Requirement in the preceding year plus the estimates of any additional increases to the Capital Financing Requirement for the current and next two financial years.

- The Council has had no difficulty meeting this requirement so far 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.

PRUDENTIAL INDICATORS

f) Total principal sums invested for periods longer than 364 days

* *This indicator allows the Council to manage the risk inherent in investments longer than 364 days.*

* The limit for 2012/13 was set at £2m.

* Local Authorities Mutual Investment Trust (LAMIT) £1m is the only investment that the Council holds on a long term basis. No further investment of over 364 days have been made in the period to 30 September 2012.

G) Credit Risk

- This indicator has been incorporated to review the Council's approach to credit risk.

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

- Credit ratings remain an important element of assessing credit risk, but they are not the sole feature in the Authority's assessment of counterparty credit risk. The Council considers the following tools to assess credit risk:

• Published credit ratings of the financial institution and its sovereign;

• 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.

- The Council can confirm that all investments were made in line with minimum credit rating criteria set in the 2012/13 TMSS:

o long-term ratings of A- or equivalent;

o long-term ratings of AA+ or equivalent for non-UK sovereigns.

H) Housing Revenue Account Limit on indebtedness

This purpose of this indicator is for the Council to report on the level of the limit imposed at the time of implementation of self-financing by the Department for Communities and Local Government.

PRUDENTIAL INDICATORS

HRA Limit on Indebtedness	31/03/2012 Actual £000s	31/03/2013 Estimate £000s	31/03/2014 Estimate £000s	31/03/2015 Estimate £000s
HRA CFR	166,853	166,853	166,853	166,853
HRA Debt Cap (as prescribed by CLG)	166,853	166,853	166,853	166,853
Difference	0	0	0	0

The HRA CFR will be reviewed in the light of the Housing Revenue Account Revised Estimates when they are available.

Counter Party Criteria

Investment	Specified	Non-Specified	Counterparty Limit
Term deposits with banks and building societies	✓	✓	£2m *
Certificates of deposit with banks and building societies	✓	✓	Include in limits above
Term deposits with other UK local authorities (incl. Police & Fire Authorities)	✓	✓	£2m
Local Authority Bills	✓	×	Include in limits above
Debt Management Account Deposit Facility	✓	×	Unlimited
Treasury Bills (T-Bills)	✓	×	Unlimited
Gilts	✓	✓	Unlimited
AAA rated Money Market Funds	✓	×	£2m per fund and 0.5% of the net asset value of the fund
Other Money Market and Collective Investment Schemes	✓	✓	£2m per Counterparty

* Additional £1m for Banks with a significant UK Government share holding and a further £1m for the current account with the daily approval of the Head of Finance

Investments are categorised as “Specified” or “Non-Specified” within the investment guidance issued by the CLG. Specified investments are sterling denominated investments with a maximum maturity of one year. They also meet the “high credit quality” as determined by the Council and are not deemed capital expenditure investments under Statute. Non-specified investments are, effectively, everything else

Each Bank and Building Society has an additional limit of 15% of total funds invested

The Council and its advisors, select financial institutions after analysis and ongoing monitoring of:

- Published credit ratings for financial institutions (minimum long term rating of A- or equivalent for counterparties; AA+ or equivalent for non-UK sovereigns)
- Credit Default Swaps (where quoted)
- Economic fundamentals (for example Net Debt as a percentage of GDP)
- Sovereign support mechanisms
- Share Prices
- Corporate developments, news, articles, markets sentiment and momentum
- Subjective overlay

Any institution can be suspended or removed should any of the factors identified above give rise to concern.

WINCHESTER CITY COUNCIL TREASURY REPORT	2011/12	2012/13		
	31/03/2012	31/07/2012	31/08/2012	30/09/2012
	£'000	£'000	£'000	£'000
Term Deposits Banks & Building Societies				
(Cash & Cash Equivalents/Short Term Investments)				
Bank of Scotland Call Account (Lloyds Bank Group)	0	2,000	1,000	1,000
Barclays	0	2,000	2,000	1,000
Lloyds Call Account	0	0	2,000	2,000
National Westminster Bank (Current Account)	1,024	2,536	1,898	2,406
National Australia Bank Ltd	0	0	2,000	2,000
Nationwide Building Society	0	2,000	2,000	0
TOTAL Banks & Building Societies	**1,024**	**8,536**	**10,898**	**8,406**
Term Deposits UK Local Authorities/LA Bills				
(Short Term Investments)				
Blaenau Gwent Council	2,000	0	0	0
Birmingham City Council	0	0	2,000	2,000
Cornwall County Council	0	2,000	2,000	2,000
Dumfries & Galloway Council	2,000	0	1,000	1,000
East Lothian Council	0	1,000	0	0
Eastleigh Borough Council	0	0	0	0
Highland Council	0	2,000	2,000	2,000
Hull City Council	0	1,000	1,000	1,000
Leeds City Council	1,000	0	0	0
Mid Lothian Council	2,000	0	0	0
Newcastle upon Tyne Council	0	2,000	2,000	2,000
Peterborough City Council	0	0	1,000	1,000
Salford City Council	2,000	2,000	2,000	2,000
TOTAL Deposits UK Local Authorities	**9,000**	**10,000**	**13,000**	**13,000**
DMADF				
(Short Term Investment)				
Debt Management Deposit Facility	500	0	0	0
TOTAL Debt Management Office	**500**	**0**	**0**	**0**
AAA Money Market Funds				
(Cash & Cash Equivalents)				
CCLA Public Sector Deposit Fund	500	500	500	500
Federated Prime Rate MMF	1,250	2,000	1,500	2,000
Morgan Stanley Fund	0	1,500	400	500
RBS Sterling Fund	0	1,400	0	300
TOTAL AAA Money Market Funds	**1,750**	**5,400**	**2,400**	**3,300**
TOTAL Cash & Cash Equivalents and Short Term Investments	**12,274**	**23,936**	**26,298**	**24,706**
Long Term Investments				
Local Authorities Mutual Investment Trust	1,000	1,000	1,000	1,000
TOTAL Cash & Cash Equivalents, Short Term & Long Term Investments	**13,274**	**24,936**	**27,298**	**25,706**
Impaired Investments				
Heritable Bank Ltd in administration	318	252	252	252
TOTAL Cash & Cash Equivalents, Short Term, Long Term & Impaired Investments	**13,592**	**25,188**	**27,550**	**25,958**

Glossary of Terms

AAA-rating The best *credit rating* that can be given to a borrower's debts, indicating that the risk of borrowing *defaulting* is minuscule.

Base rate The key interest rate set by the Bank of England. It is the overnight interest rate that it charges to banks for lending to them. The base rate - and expectations about how the base rate will change in the future - directly affect the interest rates at which banks are willing to lend money in sterling.

Basel accords The Basel Accords refer to a set of agreements by the Basel Committee on Bank Supervision (BCBS), which provide recommendations on banking regulations. The purpose of the accords is to ensure that financial institutions have enough capital to meet obligations and absorb unexpected losses.

Basis point One hundred basis points make up a percentage point, so an interest rate cut of 25 basis points might take the rate, for example, from 3% to 2.75%.

Bill A debt *security* - or more simply an IOU. It is very similar to a *bond*, but has a maturity of less than one year when first issued.

Bond A debt *security*, or more simply, an IOU. The bond states when a loan must be repaid and what interest the borrower (issuer) must pay to the holder. They can be issued by companies, banks or governments to raise money. Banks and investors buy and trade bonds.

Collateralised debt obligations (CDOs) A financial structure that groups individual loans, bonds or other assets in a portfolio, which can then be traded. In theory, CDOs attract a stronger *credit rating* than individual assets due to the risk being more diversified. But as the performance of many assets fell during the financial crisis, the value of many CDOs was also reduced.

Commercial paper Unsecured, short-term loans taken out by companies. The funds are typically used for working capital, rather than fixed assets such as a new building. The loans take the form of IOUs that can be bought and traded by banks and investors, similar to bonds.

CPI The Consumer Prices Index is a measure of the price of a bundle of goods and services from across the economy. It is the most common measure used to identify inflation in a country. CPI is used as the target measure of inflation by the Bank of England and the *ECB*.

Credit default swap (CDS) A financial contract that provides insurance-like protection against the risk of a third-party borrower defaulting on its debts. For example, a bank that has made a loan to Greece may choose to hedge the loan by buying CDS protection on Greece. The bank makes periodic payments to the CDS seller. If Greece *defaults* on its debts, the CDS seller must buy the loans from the bank at their full face value. CDSs are not just used for hedging - they are used by investors to speculate on whether a borrower such as Greece will default.

Credit rating The assessment given to debts and borrowers by a *ratings agency* according to their safety from an investment standpoint - based on their creditworthiness, or the ability of the company or government that is borrowing to repay. Ratings range from *AAA*, the safest, down to D, a company that has already *defaulted*. Ratings of BBB- or higher are considered "investment grade". Below that level, they are considered "speculative grade" or more colloquially as *junk*.

Deflation Negative inflation - that is, when the prices of goods and services across the whole economy are falling on average.

Derivative A financial contract which provides a way of investing in a particular product without having to own it directly. For example, a stock market *futures* contract allows investors to make bets on the value of a stock market index such as the FTSE 100 without having to buy or sell any shares. The value of a derivative can depend on anything from the price of coffee to interest rates or what the weather is like. Credit derivatives such as *credit default swaps* depend on the ability of a borrower to repay its debts. Derivatives allow investors and banks to hedge their risks, or to speculate on markets. *Futures*, *forwards*, *swaps* and *options* are all types of derivatives.

Fiscal policy The government's borrowing, spending and taxation decisions. If a government is worried that it is borrowing too much, it can engage in austerity - raising taxes and cutting spending. Alternatively, if a government is afraid that the economy is going into recession it can engage in fiscal stimulus - cutting taxes, raising spending and raising borrowing.

Hedging Making an investment to reduce the risk of price fluctuations to the value of an asset. Airlines often hedge against rising oil prices by agreeing in advance to buy their fuel at a set price. In this case, a rise in price would not harm them - but nor would they benefit from any falls.

Impairment charge The amount written off by a company when it realises that it has valued an asset more highly than it is actually worth.

Inflation The upward price movement of goods and services.

Junk bond A *bond* with a *credit rating* of BB+ or lower. These debts are considered very risky by the *ratings agencies*. Typically the bonds are traded in markets at a price that offers a very high *yield* (return to investors) as compensation for the higher risk of *default*.

Keynesian economics The economic theories of John Maynard Keynes. In modern political parlance, the belief that the state can directly stimulate demand in a stagnating economy, for instance, by borrowing money to spend on public works projects like roads, schools and hospitals.

LAMIT Local Authorities Mutal Investment Trust, a property fund exclusively for local authorities to invest in commercial and industrial property. Its objective is to provide a satisfactory total capital and income return over the long term

Leverage Leverage, or gearing, means using debt to supplement investment. The more you borrow on top of the funds (or *equity*) you already have, the more highly leveraged you are. Leverage can increase both gains and losses. *Deleveraging* means reducing the amount you are borrowing.

Libor London Inter Bank Offered Rate. The rate at which banks in London lend money to each other for the short-term in a particular currency. A new Libor rate is set every morning by the *British Bankers Association*.

Liquidity How easy something is to convert into cash. Your current account, for example, is more liquid than your house. If you needed to sell your house quickly to pay bills you would have to drop the price substantially to get a sale.

Monetary policy The policies of the central bank. A central bank has an unlimited ability to create new money. This allows it to control the short-term interest rate, as well as to engage in unorthodox policies such as *quantitative easing* - printing money to buy up government debts and other *assets*. Monetary policy can be used to control inflation and to support economic growth.

Money markets Global markets dealing in borrowing and lending on a short-term basis.

Options A type of *derivative* that gives an investor the right to buy (or to sell) something - anything from a share to a barrel of oil - at an agreed price and at an agreed time in the future. Options become much more valuable when markets are volatile, as they can be an insurance against price swings.

Private equity fund An investment fund that specialises in buying up troubled or undervalued companies, reorganising them, and then selling them off at a profit.

PWLB Public Works Loan Board, the function of the board, derived chiefly from the Public Works Loan Act 1875 and the National Loans Act 1968, is to consider loan applications from local authorities and other prescribed bodies and to collect repayments

Quantitative easing Central banks increase the supply of money by "printing" more. In practice, this may mean purchasing government bonds or other categories of assets, using the new money. Rather than physically printing more notes, the new money is typically issued in the form of a deposit at the central bank. The idea is to add more money into the system, which depresses the value of the currency, and to push up the value of the assets being bought and to lower longer-term interest rates, which encourages more borrowing and investment. Some economists fear that quantitative easing can lead to very high inflation in the long term.

Rating The assessment given to debts and borrowers by a *ratings agency* according to their safety from an investment standpoint - based on their creditworthiness, or the ability of the company or government that is borrowing to repay. Ratings range from *AAA*, the safest, down to D, a company that has already *defaulted*. Ratings of BBB- or higher are considered "investment grade". Below that level, they are considered "speculative grade" or more colloquially as *junk*.

Rating agency A company responsible for issuing *credit ratings*. The major three rating agencies are Moody's, Standard & Poor's and Fitch.

Recapitalisation To inject fresh *equity* into a firm or a bank, which can be used to absorb future losses and reduce the risk of *insolvency*. Typically this will happen via the firm issuing new shares. The cash raised can also be used to repay debts. In the case of a government recapitalising a bank, it results in the government owning a stake in the bank. In an extreme case, such as Royal Bank of Scotland, it can lead to *nationalisation*, where the government owns a majority of the bank.

Recession A period of negative economic growth. In most parts of the world a recession is technically defined as two consecutive quarters of negative economic growth - when real output falls. In the United States, a larger number of factors are taken into account, such as job creation and manufacturing activity. However, this means that a US recession can usually only be defined when it is already over.

Securities lending When one broker or dealer lends a security (such as a bond or a share) to another for a fee. This is the process that allows *short selling*.

Securitisation Turning something into a *security*. For example, taking the debt from a number of mortgages and combining them to make a financial product, which can then be traded (see *mortgage backed securities*). Investors who buy these securities receive income when the original home-buyers make their mortgage payments.

Security A contract that can be assigned a value and traded. It could be a share, a bond or a mortgage-backed security.

Separately, the term "security" is also used to mean something that is pledged by a borrower when taking out a loan. For example, mortgages in the UK are usually secured on the borrower's home. This means that if the borrower cannot repay, the lender can seize the security - the home - and sell it in order to help repay the outstanding debt.

Spread (yield) The difference in the *yield* of two different *bonds* of approximately the same maturity, usually in the same currency. The spread is used as a measure of the market's perception of the difference in creditworthiness of two borrowers.

Stagflation The dreaded combination of inflation and stagnation - an economy that is not growing while prices continue to rise. Most major western economies experienced stagflation during the 1970s.

Swap A *derivative* that involves an exchange of cashflows between two parties. For example, a bank may swap out of a fixed long-term interest rate into a variable short-term interest rate, or a company may swap a flow of income out of a foreign currency into their own currency.

Warrants A document entitling the bearer to receive shares, usually at a stated price.

Working capital A measure of a company's ability to make payments falling due in the next 12 months. It is calculated as the difference between the company's current assets (unsold inventories plus any cash expected to be received over the coming year) minus its current liabilities (what the company owes over the same period). A healthy company should have a positive working capital. A company with negative working capital can experience cashflow problems.

Yield The return to an investor from buying a *bond* implied by the bond's current market price. It also indicates the current cost of borrowing in the market for the bond issuer. As a bond's market price falls, its yield goes up, and vice versa. Yields can increase for a number of reasons. Yields for all bonds in a particular currency will rise if markets think that the central bank in that currency will raise short-term interest rates due to stronger growth or higher inflation. Yields for a particular borrower's bonds will rise if markets think there is a greater risk that the borrower will *default*.