CAB1599
FOR DECISION
WARD(S): GENERAL

CABINET

13 February 2008

TREASURY MANAGEMENT

REPORT OF HEAD OF FINANCE

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RECENT REFERENCES:

CAB1377 - Treasury Management ,13 February 2007

CAB1507 - Treasury Management Stewardship Report,19 September 2007

EXECUTIVE SUMMARY:

This report outlines the Council's prudential indicators for 2008/09 – 2010/11 and sets out the expected treasury operations for this period. It fulfils three key reports required by the Local Government Act 2003:

- The reporting of the prudential indicators as required by the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The treasury strategy in accordance with the CIPFA Code of Practice on Treasury Management;
- The investment strategy (in accordance with the DCLG investment guidance).

A summary report outlines the key requirements from these reports.

RECOMMENDATIONS to Council :

1. That the Treasury Management Strategy 2008/09 as set out in this report be approved, including:

- the adoption of the Prudential Indicators and Limits for 2008/09 to 2010/11;
- the Minimum Revenue Provision (MRP) Statement which sets out the Council's policy on MRP;
- the Treasury Prudential Indicators, and

- the Investment Strategy 2008/09 contained in the Treasury Management Strategy, and the detailed criteria included in Appendix B.

RECOMMENDATIONS to Cabinet:

2. That a decision be made whether to dispose of the Council's investment in the Local Authorities Mutual Investment Trust (LAMIT) or to defer until a future date.

3. To note that the Head of Finance under delegated powers will redeem the £50,000 Association of District Councils (ADC) debenture holding, when considered appropriate.

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TREASURY MANAGEMENT

Report of Head of Finance

1. Introduction

1.1 The regulatory framework for capital finance and investment in local government is covered by a system based largely on self regulation. This system requires local authorities to make sure their capital spending plans are affordable, prudent and sustainable.

1.2 Key aspects of the system are the *Code of Practice for Treasury Management in the Public Service*s and the *Prudential Code for Capital Finance in Local Government*, both developed by the Chartered Institute of Public Finance and Accountancy (CIPFA), and the *Guidance on Local Government Investments* drawn up by the Department for Communities and Local Government (CLG).

1.3 The City Council complies with these codes and the investment guidance.

2. Prudential Code

2.1 Local authorities determine their own programmes for capital investment in fixed assets that are central to the delivery of quality public services. The Prudential Code has been developed as a professional code of practice to support local authorities in taking their decisions. They are required by Regulation to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003.

2.2 The key objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable. A further key objective is to ensure that treasury management decisions are taken in accordance with good professional practice and in a manner that supports prudence, affordability and sustainability.

2.3 To demonstrate that local authorities have fulfilled these objectives, the Prudential Code sets out indicators that must be used and factors that must be taken into account. These indicators are designed to support and record local decision making in a manner that is publicly accountable.

2.4 The Prudential Code includes the following as required indicators.

3. The Capital Expenditure Plans

3.1 The Council's capital expenditure plans are summarised below and this forms the first of the prudential indicators. This expenditure can be paid for immediately (by resources such as capital receipts, capital grants etc.), but if these resources are insufficient any residual expenditure will form a borrowing need.

3.2 The Council is asked to approve the summary capital expenditure projections below. This forms the first prudential indicator:

	2007/08 Revised £million	2008/09 Estimate £million	2009/10 Estimate £million	2010/11 Estimate £million
Capital Expenditure				
Non-HRA	6.3	11.3	4.9	3.5
HRA	4.7	4.5	4.5	4.5
Financed by:				
Capital receipts	5.1	10.5	4.2	3.5
Capital grants	1.7	0.7	1.1	1.2
Capital reserves	3.9	4.6	4.1	3.3
Revenue	0.3	0	0	0
Net financing need for the year	**0**	**0**	**0**	**0**

4. <u>The Council's Borrowing Need (the Capital Financing Requirement)</u>

4.1 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of Council's underlying borrowing need. The Council is required to pay off an element of the accumulated General Fund capital spend each year through a revenue charge (the Minimum Revenue Provision), although it is also allowed to undertake additional voluntary payments.

4.2 Draft CLG Regulations are currently issued for comment which, if implemented, will require full Council to approve **an MRP Statement**. This will need to be approved in advance of each year. Whilst the regulations will revoke current MRP requirements, councils are allowed to continue historical accounting practice.

4.3 The following options are provided to councils to replace the existing Regulations

- Option 1. The Regulatory (or Existing) Method.

  Under this method MRP is calculated under the old regulations

- Option 2. The Capital Financing Requirement (CFR) Method

  MRP is calculated at 4% on the non-housing CFR at the end of the previous year. If the capital financing requirement, which is a measure of overall indebtedness, is nil or negative no MRP is required.

- Option 3. Asset Life Method

  Where capital expenditure is financed wholly or partly by borrowing or credit arrangements MRP is to be made in respect of that amount over the estimated life of the asset, subject to a maximum of 50 years, where no life can be reasonably attributed e.g. freehold land.

- Option 4. Depreciation Method

  MRP on that part of the asset financed by borrowing or credit arrangement should be made according to standard depreciation methods until the cumulative amount of such provision is equal to the amount borrowed. Thereafter the authority may cease to make MRP.

4.4 Options 1 & 2 should only be made in respect of capital expenditure incurred before 1 April 2008 or after that date if the authority is satisfied that it forms part of its Government-supported borrowing. Winchester has no such expenditure in its current capital programme.

4.5 Options 3 & 4 should be used in relation to all capital expenditure incurred on or after 1 April which is self-financed by borrowing or credit arrangement and which does not form part of the authority's Government-supported borrowing. Option 3 should be used for non-fixed asset capital expenditure e.g. capital grants and software if financed by borrowing or credit arrangements.

4.6 Applicability to Winchester City General Fund

The current capital programme does not contain any capital expenditure, which is to be financed by borrowing or by credit arrangement, since it is financed either from usable capital receipts, revenue contributions made directly or from reserves, from grants or other external contributions. It also has a negative capital financing requirement. In consequence there is no requirement to make an MRP in 2007/08 or 2008/09 and no provision has been in the revenue budgets.

4.7 Applicability to the Housing Revenue Account

Neither the previous nor the current regulations relate to the HRA, albeit that any capital expenditure is still subject to the Prudential Code as to affordability and it is open to an authority to make voluntary contributions if it so determines. The HRA has a capital financing requirement of about £10 million, which is offset by the General Fund's negative borrowing requirement. It receives Government subsidy relating to the deemed interest incurred on this balance and pays the General Fund interest on it. However no subsidy is paid for any MRP that might be made.

The HRA capital requirement is at present static since its capital expenditure is financed from the Major Repairs Allowance, sale of certain of its assets, which can be offset against the amount paid to the Government under the pooling arrangements, from HRA revenue and from capital receipts, usable for all purposes.

It would be open to the Council, subject always to prudential tests such as affordability, to increase its capital financing requirement, which would increase the interest paid to the General Fund, by not funding its capital expenditure from capital receipts (currently HRA sewage works modernisation is met from this source) but this would not attract subsidy and the cost of these works would be met from the HRA rather than the General Fund.

4.8 The timetable for implementation is very tight and so Members are asked to approve the following policy, based on the draft Regulations. Should the final regulations change this Statement, it will be re-submitted for approval.

4.9 The Council is recommended to approve the following MRP Statement :

4.10 For capital expenditure incurred before 1 April 2008 or which in the future will be Supported capital Expenditure, the MRP policy will be:

- **existing practice** - MRP will follow the existing practice outline in former CLG Regulations

4.11 From 1 April 2008 for all unsupported borrowing the MRP policy will be

- **Asset Life Method** – MRP will be based on the estimated life of the assets in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Directive);

4.12 Although it is not envisaged that MRP will be required for 2007/08 and the next three years and the Council will have the option of amending prior year policies with effect from 1 April 2008, it is asked to approve the CFR projections below.

	2007/08 Revised £million	**2008/09 Estimate £million**	**2009/10 Estimate £million**	**2010/11 Estimate £million**
Capital Financing Requirement				
CFR – Non Housing	10.1	10.1	10.1	10.1
CFR - Housing	-10.1	-10.1	-10.1	-10.1
Total CFR	**0**	**0**	**0**	**0**
Movement in CFR	**0**	**0**	**0**	**0**

Movement in CFR represented by				
Net financing need for the year (above)	0	0	0	0
MRP/VRP and other financing movements	0	0	0	0
Movement in CFR	**0**	**0**	**0**	**0**

5. <u>The Use of the Council's resources and the Investment Position</u>

5.1 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or 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	**2007/08 Revised £million**	**2008/09 Estimate £million**	**2009/10 Estimate £million**	**2010/11 Estimate £million**
GF Fund balance	2	2	2	2
HRA Balances	2	2	2	2
Capital receipts	6	0	5	5
Earmarked reserves	8	6	3	3
Other Balances.	1	1	1	0
Total Core Funds	**19**	**11**	**13**	**12**
Working Capital*	13	5	8	6
Expected Investments	**19**	**11**	**13**	**12**

***** Working capital balances shown are estimated year end; these may be higher mid year. They also include reserves such as the Major Investment which is used for both revenue and capital purposes

6. Limits to Borrowing Activity

6.1 Within the prudential indicators there are a number of key indicators to ensure the Council operates its activities within well defined limits

6.2 For the first of these the Council needs to ensure that its total borrowing net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2008/09 and the following two financial years.

£m	2007/08 Revised	2008/09 Estimated	2009/10 Estimated	2010/11 Estimated
Gross Borrowing	0	0	0	0
Investments	19	11	13	12
Net Borrowing	-19	-11	-13	-12
CFR	0	0	0	0

6.3 The Head of Finance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

6.4 A further two prudential indicators control or anticipate the overall level of borrowing. These are:

6.5 The Authorised Limit for External Debt – This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by full Council.

6.6 The Operational Boundary for External Debt –This indicator is based on the expected maximum external debt during the course of the year; it is not a limit.

6.7 The Council is asked to approve the following Authorised Limit and Operational Boundary:

Authorised limit	**2007/08 Revised £million**	**2008/09 Estimate £million**	**2009/10 Estimate £million**	**2010/11 Estimate £million**
Borrowing	7	7	7	7
Other long term liabilities	0	0	0	0
Total	7	7	7	7
Operational Boundary	**2007/08 Revised £million**	**2008/09 Estimate £million**	**2009/10 Estimate £million**	**2010/11 Estimate £million**
Borrowing	2	2	2	2
Other long term liabilities				
Total	2	2	2	2

Although the authority has no long-term borrowing requirement, a limit of £7million is proposed, to allow for unforeseen circumstances, with an operational boundary set at £2 million to allow for temporary cashflow needs, pending receipt of other funds.

7. Affordability Prudential Indicators

7.1 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. The Council is asked to approve the following indicators:

7.2 Actual and Estimates of the 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 non-HRA (General Fund) is negative because it has investments but no borrowing, whereas the HRA has a positive capital financing requirement.

	2007/08 Revised %	**2008/09 Estimate %**	**2009/10 Estimate %**	**2010/11 Estimate %**
Non-HRA	-22.4	-21.1	-19.7	-18.7
HRA	7.5	9.9	10.1	9.7

7.3 Estimates of the incremental impact of capital investment decisions on the Council Tax – This indicator identifies the revenue costs associated with *new schemes* introduced to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans.

7.4 Incremental impact of capital investment decisions on the Band D Council Tax, reflecting changes to the capital programme since last approve by Council. This is effectively the cumulative effect of interest lost on investments

	Proposed Budget 2008/09 £p	**Forward Projection 2009/10 £p**	**Forward Projection 2010/11 £p**
Council Tax - Band D	-2.8	1.66	1.90

7.5 Estimates of the incremental impact of capital investment decisions on Housing Rent levels – Similar to the Council tax calculation this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in this budget report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

7.6 Incremental impact of capital investment decisions Housing Rent levels

	Proposed Budget 2008/09 £p	**Forward Projection 2009/10 £p**	**Forward Projection 2010/11 £p**
Weekly Housing Rent levels	0	0	0

There is no incremental cost to the HRA as where not financed from subsidy (the major repairs allowance), it is financed from capital receipts, the interest on which would accrue to the General Fund

8. Treasury Management Strategy 2008/09 – 2010/11

8.1 The treasury management service is an important part of the overall financial management of the Council's affairs. The prudential indicators in **Appendix A** consider the affordability and impact of capital expenditure decisions, and set out the Council's overall capital framework. The treasury service considers the effective funding of these decisions. Together they form part of the process which ensures the Council meets balanced budget requirement under the Local Government Finance Act 1992. There are specific treasury prudential indicators included in this strategy which require approval.

8.2 This strategy covers:

- The Council's debt and investment projections;

- The expected movement in interest rates;
- The Council's borrowing and investment strategies;
- Treasury performance indicators;
- Specific limits on treasury activities;
- Any local Treasury issues.

9. Debt and Investment Projections 2008/09 – 2010/11

9.1 The Council is debt free and has no need to borrow to finance the capital programme. The only borrowing it is likely to undertake is short-term to cover temporary cashflow difficulties. In terms of investments, as at 31 December 2007 its short-term investments totalled £31 million. It also has £1 million invested in the Local Authorities Mutual Investment Trust (LAMIT) currently valued at £1.5million and a debenture of £50,000.

9.2 The projections are

	2007/08 Revised £million	**2008/09 Estimate £million**	**2009/10 Estimate £million**	**2010/11 Estimate £million**
External Debt				
Debt at 1 April	0	0	0	0
Expected change in debt	0	0	0	0
Debt at 31 March	0	0	0	0
Operational Boundary	2	2	2	2
Investments				
Total Investments at 31 March	19	11	14	12
Investment change	-6	-8	+3	-2

9.3 The related impact of the above movements on the revenue budget are:

	2007/08 Revised £million	**2008/09 Estimated £million**	**2009/10 Estimated £million**	**2010/11 Estimated £million**
Revenue Budgets				
Interest on Borrowing	0	0	0	0
Related HRA Charge	-0.5	-0.5	-0.4	-0.4
Net General Fund Borrowing Cost	-0.5	-0.5	-0.5	-0.5
Investment income	1.9	1.1	0.8	0.8

9.4 **Expected Movement in Interest Rates**

Medium-Term Rate Forecasts (averages)

	Bank Rate	1-year LIBOR	5-year Gilt	20-yr Gilt	50-yr Gilt
2006/07	4.8	5.3	4.9	4.4	4.0
2007/08	5.6	6.0	5.3	4.9	4.5
2008/09	4.8	4.7	4.7	4.8	4.6
2009/10	4.8	4.8	4.8	4.7	4.6
2010/11	5.0	5.3	4.9	4.8	4.8
2011/12	5.2	5.5	5.3	5.2	5.1

*PWLB borrowing is normally between 0.10% - 0.15% above the equivalent gilt yield

10. **Borrowing Strategy 2008/09 – 2010/11**

10.1 The uncertainty over future interest rates increases the risks associated with treasury activity and as a result the Council will take a cautious approach to its treasury strategy.

10.2 The risks associated with long-term fixed interest rates are expected to be for higher rates over the medium term. Since it is not envisaged that there will be a capital financing requirement it is unlikely any medium or long-term borrowing will be necessary, although temporary borrowing may occur occasionally for short-term cashflow measures. However, should the situation change the Head of Finance, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above. It is likely that longer term fixed rates will be considered earlier if borrowing rates deteriorate.

11. **Investment Counterparty and Liquidity Framework**

11.1 The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration.

11.2 Currently the Council's investment guidelines relate to types of institution rather than having formal regard to individual ratings. Acting on advice from the Council's brokers (Appendix B), it is recommended that the following guidelines be introduced

11.3 The Head of Finance will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. This criteria is separate to that which chooses Specified and Non-Specified investments as it selects which counterparties the Council will choose rather than defining what its investments are. The rating criteria use the lowest common denominator method of selecting counterparties and applying limits.

11.4 Banks – the Council will use banks which have at least the following Fitch, Moody's and Standard and Poors ratings (where rated):

- Short Term **–** F1(or equivalent) from Fitch, Moody's (P-1) or Standard *& Poor's* (A-1)
- Long Term **–** A (single category A) from FitchMoody's or S&P
- Individual / Financial Strength **–** C (Fitch / Moody's only)
- Support **–** 3(Fitch only)

11.5 Bank Subsidiary and Treasury Operations – the Council will use these where the parent bank has the necessary ratings outlined above.

11.6 Building Societies **–** the Council will use the top 30 building societies providing that they have assets over £500 million. The limits will be defined by the ratings as outlined above and with regard to the current counterparty report produced by the Council's appointed Brokers.

11.7 Money Market Funds – £5 Million

11.8 UK Government (including gilts and the Debt Management Office)

11.9 Local Authorities, Parish Councils etc

11.10 Supranational institutions

11.11 Although at present, given current money market uncertainties and the level of the current capital programme, it is unlikely that investments will be made for periods exceeding 364 days, it is recommended that the time limits for institutions on the Council's Counterparty List are set at a maximum of 3 years.

11.12 The proposed criteria for Specified and Non-Specified investments are shown in Appendix B for approval.

11.13 The Time limits for institutions in the Council's Counterparty list are as follows (these cover both specified and Non-specified Investments):

	Fitch	Moody's	Standard & Poors	Money Limit	Time Limit
Upper Limit Category	**A**	**A**	**A**	**£5m**	**3yrs**
Middle Limit Category	**F1**	**P-1**	**A-1**	**£3m**	**2yrs**
Lower Limit Category	**-**	**-**	**-**	**£2**	**1yrs**

The lower limit category would include unrated top thirty building societies with assets in excess of £500 million and other unlisted institutions appearing on the brokers approved counterparty list

12. **Investment Strategy 2008/09 – 2010/11**

12.1 Expectations on shorter-term interest rates, on which investment decisions are based, show a likelihood of the current 5.50% Bank Rate being the peak with the next fall in early 2008. The Council's investment decisions are based on comparisons between the rises priced into market rates against the Council's and advisers own forecasts. It is likely that investment decisions will be made for longer periods with fixed investments rates to lock in good value and security of return if opportunities arise, subject to over riding credit counterparty security. The Head of Finance, under delegated powers, will undertake the most appropriate form of investments depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above.

13. **Treasury Management Prudential Indicators and Limits on Activity**

13.1 There are four further treasury prudential indicators the Council is asked to approve:

	2008/09 %	**2009/10 %**	**2010/11 %**
Interest rate Exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100	100	100
Limits on variable interest rates	£7million	£7million	£7million
Maturity Structure of fixed interest rate borrowing 2008/09			
		Lower	**Upper**
Under 12 months		0%	100%
12 months to 2 years		0%	100%
2 years to 5 years		0%	100%
5 years to 10 years		0%	100%
10 years and above		0%	100%
Maximum principal sums borrowed			
Authorised limit	£7m	£7m	£7m
Maximum principal sums invested > 364 days			
Principal sums invested > 364 days	£7m	£7m	£7m

14. **Performance Indicators**

14.1 The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are:

- Debt – Borrowing - Average rate of borrowing for the year compared to average available
- Debt – Average rate movement year on year
- Investments – Internal returns above the 7 day LIBID rate
- Investments – External fund managers - returns 110% above 7 day compounded LIBID.

The results of these indicators will be reported in the Treasury Annual Report for 2007/08.

15. Other Considerations:

15.1 The Council currently holds 422,654 property fund units in the Local Authorities' Mutual Investment Trust (LAMIT), which were purchased in 1989/90 at a cost price of £1million. The value of the LAMIT is subject to market fluctuations. Performance over the past 5 years has been as follows:

Valuation date	Value*	Gain / (Loss) on investment (unrealised)
31st March 2002	£953,000	(47,000)
31st March 2003	£981,000	(19,000)
31st March 2004	£1,043,000	43,000
31st March 2005	£1,193,000	193,000
31st March 2006	£1,136,000	136,000
31st March 2007	£1,500,000	500,000

**Source: Statement of Accounts*

15.2 The latest quoted bid price is £1.54 million. Disposal can be made at any time. Any decision as to whether to dispose or not should have due regard to any anticipated change in the capital value, future cash needs and anticipated dividends compared with yields from replacement investments.

15.3 Information received from the City's brokers suggest that performance, although lower than in recent years, will still be ahead of what may be achieved through alternative forms of investment, but of course there will always be an element of risk as regards any investment.

15.4 The investment when made was not made from capital resources as would be necessary under current regulations. Therefore the additional resources that would be generated from sale would be the amount received after the deduction of the original £1m cost. .

15.5 The Cabinet is therefore requested to decide whether to dispose of the asset or defer a decision to a later date.

15.6 The Council also holds a debenture of £50,000 with the Association of District Councils (ADC) which can only be redeemed at certain intervals. This is non-interest bearing. It is proposed that the Head of Finance dispose of this when the next opportunity arises in order that investment interest be optimised on the Council's balances. .

16. CORPORATE STRATEGY (RELEVANCE TO):

16.1 Treasury Management supports the Corporate Strategy by demonstrating high standards in managing the taxpayers' money.

17. RESOURCE IMPLICATIONS:

17.1 Interest rate changes continue to have a significant effect on the annual budget, generating high levels of investment income (£1.1m in the current budget). A change of 1% alters income by £10,000 for every £1m invested, which on an investment of, say, £25m, equates to £250,000, and approximates to a council tax increase or decrease of 5%.

18. BACKGROUND DOCUMENTS:

18.1 Operational and financial records held in the Finance Directorate

19. APPENDICES:

Appendix A The Council's overall capital framework and prudential indicators relating to affordability and the impact of capital expenditure.

Appendix B Detailed Treasury Management Criteria

Appendix C Rating Definitions

PRUDENTIAL INDICATORS RELATING TO AFFORDABILTY AND CAPITAL EXPENDITURE

	2007/08 Revised	2008/09 Estimated	2009/10 Estimate	2010/11 Estimate
	£000	£000	£000	£000
CAPITAL EXPENDITURE AND THE SOURCES OF FINANCE				
Capital Expenditure – General Fund				
Supported spend	0	0	0	0
Unsupported spend	6,336	11,295	4,830	3,522
Total spend	6,336	11,295	4,830	3,522
Capital receipts	3,769	9,340	2,982	2,352
Capital grants & Contributions	1,701	720	1,070	1,170
Earmarked Reserves	866	1,235	778	0
Revenue	0	0	0	
Total financing	6,336	11,295	4,830	3,522
Net financing need	0	0	0	0
Capital Expenditure – Housing Revenue Account				
Supported spend	0	0	0	0
Unsupported spend	4,676	4,525	4,525	4,525
Total spend	4,676	4,525	4,525	4,525
Financed by:				
Capital receipts	1,350	1,200	1,200	1,200
Capital grants	0			
Major Repairs Reserve	3,076	3,325	3,325	3,325
Revenue	250			
Total financing	4,676	4,525	4,525	4,525
Net financing need	0	0	0	0
Capital Expenditure – Total				
Supported spend	0	0	0	0
Unsupported spend	11,012	15,820	9,355	8,047
Total spend	11,012	15,820	9,355	8,047
Financed by:				
Capital receipts	5,119	10,540	4,182	3,552
Capital grants	1,701	720	1,070	1,170
Capital reserves	3,942	4,560	4,103	3,325
Revenue	250	0	0	0
Total financing	11,012	15,820	9,355	8,047
Net financing need	0	0	0	0

	2006/07 Actual	2007/08 Est	2008/09 Est	2009/10 Est	2010/11 Est
	£000	£000	£000	£000	£000
The Capital Financing Requirement					
The Capital Financing Requirement - General Fund					
Opening Balance	-10,131	-10,131	-10,131	-10,131	-10,131
Net financing need	0	0	0	0	0
Less MRP & VRP	0		0	0	0
Less other financing movements	0	0	0	0	0
CFR Closing balance	-10,131	-10,131	-10,131	-10,131	-10,131
Net movement in CFR	0	0	0	0	0
Opening Balance	10,131	10,131	10,131	10,131	10,131
Net financing need	0				
Voluntary RP					
Less other financing movements					
CFR Closing balance	10,131	10,131	10,131	10,131	10,131
Net movement in CFR	0	0	0	0	0
The Capital Financing Requirement - Total					
Opening Balance	0	0	0	0	0
Net financing need	0	0	0	0	0
MRP & VRP	0	0	0	0	0
Less other financing movements	0	0	0	0	0
CFR Closing balance	0	0	0	0	0
Net movement in CFR	0	0	0	0	0

	2007/08 Estimated £000	2008/09 Estimated £000	2009/10 Estimated £000	2010/11 Estimate £000
EXTERNAL DEBT & OTHER LONG TERM LIABILITIES				
Opening Balance 1 April	0	0	0	0
Maturing Debt	0	0	0	0
Borrowing - Maturing Debt	0	0	0	0
Borrowing - Change in CFR	0	0	0	0
Total Debt 31 March	0	0	0	0
Net movement in debt	0	0	0	0
Other long term liabilities	50	25	0	0

AUTHORISED LIMIT AND OPERATIONAL BOUNDARY BORROWING				
	£million	**£million**	**£million**	**£million**
Authorised Limit	7	7	7	7
Operational Boundary	2	2	2	2
INVESTMENTS				
	£million	**£million**	**£million**	**£million**
Opening Balance 1 April	25	19	11	14
Cash flow & Reserve	-6	-8	3	-2
Total Investments 31 March	19	11	14	12
Net movement in investments	-6	-8	3	-2

The proposed criteria for Specified and Non-Specified investments

The Office of the Deputy Prime Minister (now CLG) issued Investment Guidance on 12th March 2004, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds which are under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for Councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the Code on 11 February 2004 and will apply its principles to all investment activity. In accordance with the Code, the Head of Finance has produced its treasury management practices. This part, TMP 1(5), covering investment counterparty policy requires approval each year.

Annual Investment Strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for decision making on investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

This strategy is to be approved by full Council.

The investment policy proposed for the Council is:

Strategy Guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified Investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are low risk assets where the possibility of loss of principal or investment income is small. These would include investments with:

1. The UK Government (such as the Debt Management Office, UK Treasury Bills or a Gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.
3. A local authority, parish council or community council.
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency.
5. A body that has been awarded a high credit rating by a credit rating agency (such as a bank or building society .

For category 4 this covers pooled investment vehicles, such as money market funds, rated A by Standard and Poor's, Moody's or Fitch rating agencies.

For category 5 this covers bodies with a minimum rating of F1 (or the equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies. Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies. This criteria is £5million for an A rating and £3m for F1 or equivalent with maximum investment periods of 3 years and 2 years respectively

Non-Specified Investments – Non-specified investments are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investments would include any sterling investments with:

	Non Specified Investment Category	**Limit (£ or %)**
a.	**Supranational Bonds greater than 1 year to maturity** **(a) Multilateral development bank bonds** - These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Investment Bank etc.). **(b) A financial institution that is guaranteed by the United Kingdom Government** (e.g. The Guaranteed Export Finance Company {GEFCO}) The security of interest and principal on maturity is on a par with the Government and so very secure, and these bonds usually provide returns above equivalent gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	 £3m £3m
b.	**Gilt edged securities** with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	£3m
c.	**Building societies not meeting the basic security requirements under the specified investments**. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The council may use such building societies which have a minimum asset size of £500m, but will restrict these type of investments to £2million) for periods not exceeding 364 days	£2m
d.	Any **bank or building society** that has a minimum long term credit rating of F1 or equivalent for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	Maximum limit of £2 million, so long as no more than 20% of investments have maturities of longer than one year at any one time.
e.	Any **non rated subsidiary** of a credit rated institution included in the specified investment category. These institutions will be included as an investment category subject to a guarantee from the parent company and the maximum period of investment.	
f.	**Share capital or loan capital** in a body corporate – The use of	This will limited

	these instruments will be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. Revenue resources will not be invested in corporate bodies.	to the Councils existing holdings

The Monitoring of Investment Counterparties - The credit rating of counterparties will be monitored regularly. The Council receives credit rating advice from its advisors, Butlers, on a daily basis and as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Director of Finance and, if required new counterparties which meet the criteria will be added to the list.

Advice from Council's Brokers on Investment Strategy

Credit Ratings & Counterparty Lists

Introduction

The Council currently estimates its internal fund balances at around £24 million. Discussions with officers have suggested that this level will likely fall in coming years as the Council uses up its capital receipts. Aside from this changing financial situation officers also wish to explore the use of a credit rating criteria to both choose counterparties and apply limits to achieve a more consistent approach to assessing counterparties. The potential strategy outlined below has been based upon the English Guidance as issued by the DCLG and CIPFA's Code of Practice in 2004.

At the present time, the Council uses a mixture of a static list and credit ratings for selecting counterparties. Money limits vary between £1m and £5m.

The issues that both ourselves and officers feel need addressing are outlined below:

1. Adjusting the criteria for initially selecting counterparties.
2. Changing the way limits are applied to institutions.

Information on the relationship between long and short term ratings, credit rating definitions and the building society sector can be found in the Appendices at the end of the report.

BACKGROUND

Under the present investment regime, a Council needs a counterparty system that enables it to use high quality institutions while maintaining flexibility of use as well as trying to maximise its levels of return on any funds invested.

This report looks at the issue of investment counterparties separately. Although they are obviously integral to the whole investment process, the basis and creation of a list of names is a separate operation for the Council to undertake. **The Specified and Non-Specified criteria that the Guidance creates are judging an investment – not an institution**.

1. CREATION OF A LENDING LIST

The Council currently uses Fitch ratings to select Clearing Banks. These are the only banks the Council can use and aside from these, the main bulk of counterparties are building societies. These are selected purely by asset size. Following discussions with officers, it was decided that the policy of using credit ratings should be widened to encompass both banks and building societies and banks should not just be restricted to those members of the Clearing Banks (APACS) Association. In addition, rather than focus on Fitch ratings, the new methodology will use ratings from all three major rating agencies - Fitch, Moody's and Standard & Poors. We would also suggest the Council applies a Lowest Common Denominator approach to assessing institutions. There are many benefits of using this type of system. The major ones are outlined below:

1. The Council will benefit from additional names being added to its list as not all counterparties are rated by all agencies. By using all three agencies, the Council's list will therefore contain the widest number of counterparties that meet its criteria. A clear example of this is UK building societies; Fitch rates around 10 societies, whereas Moody's rates around 14. All of the Moody's ratings are strong and as such, just by using Moody's ratings, the Council will add another 4 viable counterparties to its list.

2. If the Council adopted a Lowest Common Denominator approach to using ratings it will also benefit from a risk perspective. This method will remove counterparties whose ratings from one agency would suggest they are useable, but they are poorly rated by another and would therefore prevent their use. Not all counterparties are rated the same by the agencies and in some circumstances a formal rating review by one agency ahead of others may highlight a concern about the counterparty. This concern will then be applied to its ratings and thus remove the counterparty from the Council's list. The LCD approach using all three rating agencies will therefore be a useful risk control measure.
3. The other main benefit is that the criteria can also be used to assign limits. These limits would then ensure that all similarly rated counterparties are treated in the same way. In addition, limits would automatically be changed as and when any rating change occurred. This would be a change to the present system where all counterparties are blocked together by type and then assigned limits.
4. By widening its scope to use banks other than clearing organisations, the Council will introduce a wide range of potentially useable organisations. Some of these may be impossible to use due to their minimum dealing size, but the Council will benefit from some other, smaller organisations who will competitively quote. By using these organisations, the Council will further benefit from spreading some of its investments away from the building society sector.

Taking the above into account, we would suggest the Council uses all rating categories for initially selecting counterparties. This way, the Council will analyse all aspects of a counterparty (as defined through the rating categories) rather than just focusing on particular areas. The use of all ratings when initially selecting counterparties will ensure any "rogue" institutions who may have a weak particular rating is not used.

The criteria outlined below should be applied to all financial institutions, whatever their country of origin. Credit ratings are internationally comparable and although no two institutions will ever be identical (in terms of risk) the Council should not reduce its capacity to invest by imposing overseas restrictions. In addition, it must be realised that when a deal is made with an overseas institution, it is highly unlikely that the money will actually go abroad. Normally, the organisation will either have a branch in the UK where the deposit will be "held" or they will have an account at a UK institution where the money will be "placed".

Evidently, there maybe times when, say due to geopolitical reasons, the Council may wish to exclude names from certain countries (or countries / regions themselves), but aside from these exceptional circumstances, institutions should not normally be excluded.

Using the Butler's credit rating database the Council's new list will only contain "active" names in the money markets. This method will try to ensure that obscure, irrelevant names will not appear on a list, while those names that are included will both meet the criteria and also be a potential outlet for the Council's money. Please note that the potential use for some counterparties may well be for Local Authority external fund managers and as such not all counterparties shown will necessarily be "active" for internally managed funds. Our system can manually remove names if you wished to trim lists to just those which the Council could use for internal purposes.

The following sections look at each individual type of counterparty and gives advice as to what initial selection criteria should be used.

<u>a). Banks</u>

The table below outlines the relationships that exist between the short and long term ratings of the three main rating agencies.

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

There is some correlation between these ratings, the Individual (Fitch) / Financial Strength (Moody's) ratings and Fitch's Support rating. However, it is not quite so clear cut. For example, there are two banks rated P-1, Aa1 by Moody's, one of which has a financial strength rating of "E" (the lowest rating) and another that has a rating of "A-" (just below the top rating).

There is a fundamental difference between the two groups of ratings itemised below:

1. Individual / Financial strength ratings / Support rating
2. Short / Long term ratings

Unlike the short / long term rating, the former set is **not** assessing the ability of an entity to meet its financial obligations in a timely manner…

- The Individual rating is trying to *"…assess how a bank would be viewed if it were entirely independent and could not rely on external support"*. **[FITCH]**
- The Financial Strength rating *"…can be understood as a measure of the likelihood that a bank will require assistance from third parties such as its owners, its industry group, or official institutions"*. **[MOODY'S]**
- The Support rating is *"…Fitch's assessment of a potential supporter's (either a sovereign state's or an institutional owner's) propensity to support a bank and of its ability to support it"*. **[FITCH]**

In order to stop "rogue" institutions on its list (ie those whose individual rating and/or support rating is too low, despite having good short and long term ratings), we suggest that the Council uses the following criteria for initially selecting banking institutions:

- **Short Term Rating**
  F1 (or equivalent) from Fitch, Moody's (P-1) or Standard & Poors (A-1)

- **Long Term Rating**
  A (single A category) or equivalent from Fitch, Moody's or Standard & Poors.

- **Individual / Financial Strength Rating**
  C from Fitch or Moody's

- **Support Rating**
  3 from Fitch

Business reserve accounts (such as those from Abbey National and Bank of Scotland) are merely another form of a deposit with a bank and **NOT** something that needs a separate category. Unlike Money Market Funds, where the bank is merely running the fund rather than actually taking the investment on its own book, BRAs are not rated separately and therefore the Council will need to take account of the bank's own ratings when making this form of deposit.

b). Bank Subsidiaries & Treasury Operations

There are a small number of bank subsidiaries that still operate in money markets (or deal direct) that might need to be accounted for in a counterparty list. Some of these would qualify automatically due to their having ratings (ie Ulster Bank Limited), but others, such as Bank of Scotland (Ireland) have no ratings. If the Council wishes to continue using unrated "subs", we suggest that they are allowed on, subject to the parent bank having the necessary credit ratings to qualify in its own right for the Council's list.

For investments where the counterparty is the treasury operation of a bank (ie Abbey National via the money markets where investments are made with Abbey National Treasury Services) the situation is slightly different. Most of these organisations will have short and long term ratings, but may not have other ratings. This is due to the fact that they cannot be judged on a **stand alone basis** or would expect to receive outside support **independent** of their "parent" organisation. They are merely the Treasury division or dealing operation of a bank and therefore we would suggest that assuming both the "parent" and Treasury organisation have the necessary short and long term ratings (where supplied) and the "parent" has the necessary other ratings, then the Council should be happy to use them.

When dealing with either of these categories, it would be advisable to impose group limits on investments in addition to individual limits on institutions.

c). Building Societies

There are two methods that Local Authorities use to determine which Building Societies they use. The first method is to solely use credit rating as outlined for banks above and the second method is to use building society asset size as the threshold. Other Local Authorities who use this method will normally set their threshold at either £1bn or £500m.

At present the Council uses an asset threshold of £500m which we would recommend continues.

d). Money Market Funds

Under the previous Approved Investment regulations the definition of which money market funds a Local Authority was allowed to use included a minimum credit rating. The current regulations and investment guidance has removed this and instead refers to their use via the words "…investment scheme which has been awarded a high credit rating…" At the present time we would suggest that only money market funds with a AAA rating from either Fitch, Moody's or Standard & Poors are included on a counterparty list. We would suggest that the Council changes its criteria to allow the use of these funds. They may prove a valuable addition to officers' ability to invest funds – especially if funds are only invested short term.

e). Other Institution Types

Aside from banking institutions and building societies, the Council will also want to continue including the following on their counterparty list:

1. UK Government (Gilts / DMADF)
2. Local authorities, parish councils etc.

These are mentioned explicitly in the Guidance and associated legislation and therefore we would not expect the Council to lay down specific criteria for including these types of institution in the same way as they do for banks and building societies. However, they would still need to be mentioned in the overall criteria for how the counterparty list is to be constructed.

2. COUNTERPARTY LIMITS

At the present time, the Council limits vary between £1m and £5m. Time limits allow for investment beyond 364 days.

As with the selection of counterparties above, we would suggest that the Council uses ratings (where possible) to define limits. This will ensure that the application of limits is much more consistent with the potential risk as evidenced by the rating of an institution. The most straightforward way to do this would be to split counterparties into 3 main sections - using ratings as the primary driver.

The Council has overall internal funds of around £24m at the present time. Although there is no set limit, or even official guide, to overall exposure limits we believe that the Council (where possible and practical) should use limits which allow no more than 25% of outstanding investments to be placed with any one institution at the time an investment is made. If the overall investment fund size does vary during a year then the Council may wish to use percentages as an overriding measure for limits. At other times the Council should have in place formal monetary amounts to determine how much can be placed with an institution.

The short and long term ratings are the categories defined as the likelihood of an investors receiving their money back on the terms they invested it. Bearing this in mind, we would suggest that the Authority uses these as their basis for investment limits. The main reasoning behind the following limit suggestions is to both simplify and ensure consistency. The suggestions should not make significant changes to the current setup, but where it does, it will be for prudent reasons. Importantly, the levels are still consistent with only using high quality counterparties.

Time limits are more difficult to quantify. The Council has a significant Capital programme in place which, if fully undertaken could lower overall investments significantly in the coming 2-3 years. However, slippage, alternative funding and changes to the programme should allow some investment beyond 364 days. However, following discussions with officers, it has been decided to leave discretion on how long investments can be made for on an individual basis. It is hoped that if future planning becomes clearer, then formal limits can be introduced. We would make one exception to this and that is to place time limits of 1 year on unrated organisations. The lack of ratings does introduce extra uncertainty in their use and for this fact we would limit them to this level.

Upper Limit - £5m
Short Term – F1+ (or equivalent from Moody’s and Standard & Poors)
Long Term – AA- or better (or equivalent from Moody’s and Standard & Poors)

Lower Limit - £3m
Short Term – F1 (or equivalent from Moody’s and Standard & Poors)
Long Term – A- or better (or equivalent from Moody’s and Standard & Poors)

Unrated Building Society / Subsidiary Limit - £2m and 1 year
This limit would only be used if the Council wished to incorporate unrated societies / subsidiaries into its list. The limits suggested are lower than those stated above and match the

status of the names being used. Being unrated, the Council will not have the same level of comfort in using the institutions as they will with a rated body. Nevertheless, the size of the societies included within this group as well as the status of unrated subsidiaries warrant these level of limits. We believe that there are presently only 2 active unrated subsidiaries – Bank of Scotland (Ireland) and Adam & Co. If the Council wished to continue using them we would suggest giving them the same limits as per unrated building societies.

Other Institution Limit - £5m
At present, this would include other Local Authorities, the DMADF and Money Market Funds. These are either actually "AAA" rated (MMFs) or have implied high ratings (DMADF and Local Authorities) and therefore warrant the highest monetary limit.

CONCLUSIONS

1. The above counterparty list and associated monetary criteria should enable the Council to invest with a wider range of high quality institutions.
2. The main changes suggested are to formalise the creation of a list by using credit ratings where possible and standardise the application of limits.
3. These changes should increase the number of institutions on the Council's list while keeping to the key remit of security being of paramount importance.
4. Credit ratings are a statement of opinion, not a guarantee. Therefore, even with the highest rated organisations clients should ensure that suitable parameters are in place to avoid undue risk.
5. The accompanying counterparty list details the organisations that could be used and what limits would be applied to them, according to their current ratings.

If you wish to discuss any of the details in this report, then please do not hesitate to contact us.

Dan Willson
Treasury Manager – August 2007

Appendix 1 – Rating Definitions

Fitch – Short Term Ratings

F1

Indicates the strongest capacity for timely payment of financial commitments; may have an added "+" to denote any exceptionally strong credit feature.

F2

A satisfactory capacity for timely payment of financial commitments, but the margin of safety is not as great as in the case of the higher ratings.

Moody's – Short Term Ratings

Prime-1

Banks rated Prime-1 for deposits offer superior credit quality and a very strong capacity for timely payment of short-term deposit obligations.

Prime-2

Banks rated Prime-2 for deposits offer strong credit quality and a strong capacity for timely payment of short-term deposit obligations.

Standard & Poor's – Short Term Ratings

A-1

An obligor rated 'A-1' has STRONG capacity to meet its financial commitments. It is rated in the highest category by Standard & Poor's. Within this category, certain obligors are designated with a plus sign (+). This indicates that the obligor's capacity to meet its financial commitments is EXTREMELY STRONG.

A-2

An obligor rated 'A-2' has SATISFACTORY capacity to meet its financial commitments. However, it is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors in the highest rating category.

Fitch – Long Term Ratings

AAA Highest credit quality.

'AAA' ratings denote the lowest expectation of credit risk. They are assigned only in case of exceptionally strong capacity for timely payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.

AA Very high credit quality.

'AA' ratings denote a very low expectation of credit risk. They indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.

A High credit quality.

'A' ratings denote a low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings.

Note: "+" or "-" may be appended to a rating to denote relative status within major rating categories. Such suffixes are not added to the 'AAA' Long-term rating

Moody's – Long Term Ratings

Aaa
Banks rated Aaa for deposits offer exceptional credit quality and have the smallest degree of risk. While the credit quality of these banks may change, such changes as can be visualized are most unlikely to materially impair the banks' strong positions.

Aa
Banks rated Aa for deposits offer excellent credit quality, but are rated lower than Aaa banks because their susceptibility to long-term risks appear somewhat greater. The margins of protection may not be as great as with Aaa-rated banks, or fluctuations of protective elements may be of greater amplitude.

A
Banks rated A for deposits offer good credit quality. However, elements may be present that suggest a susceptibility to impairment over the long term.

Note: Moody's applies the numerical modifiers 1, 2, and 3 in each generic rating category from Aa to Caa. The modifier 1 indicates that the bank is in the higher end of its letter-rating category; the modifier 2 indicates a mid-range ranking; and the modifier 3 indicates that the bank is in the lower end of its letter-rating category.

Standard & Poor's – Long Term Ratings

AAA
An obligor rated 'AAA' has EXTREMELY STRONG capacity to meet its financial commitments. 'AAA' is the highest Issuer Credit Rating assigned by Standard & Poor's.

AA
An obligor rated 'AA' has VERY STRONG capacity to meet its financial commitments. It differs from the highest rated obligors only in small degree.

A
An obligor rated 'A' has STRONG capacity to meet its financial commitments but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors in higher-rated categories.

Note: Plus (+) or minus (-) The ratings from 'AA' to 'CCC' may be modified by the addition of a plus or minus sign to show relative standing within the major rating categories.

Fitch – Individual Rating

A
A very strong bank. Characteristics may include outstanding profitability and balance sheet integrity, franchise, management, operating environment, or prospects.

B
A strong bank. There are no major concerns regarding the bank. Characteristics may include strong profitability and balance sheet integrity, franchise, management, operating environment or prospects.

C
An adequate bank which, however, possesses one or more troublesome aspects. There may be some concerns regarding its profitability and balance sheet integrity, franchise, management, operating environment or prospects.

Note: In addition, we use gradations among these five ratings, i.e. A/B, B/C, C/D, and D/E.

Moody's – Financial Strength Rating

A

Banks rated A possess superior intrinsic financial strength. Typically, they will be institutions with highly valuable and defensible business franchises, strong financial fundamentals, and a very predictable and stable operating environment.

B

Banks rated B possess strong intrinsic financial strength. Typically, they will be institutions with valuable and defensible business franchises, good financial fundamentals, and a predictable and stable operating environment.

C

Banks rated C possess adequate intrinsic financial strength. Typically, they will be institutions with more limited but still valuable business franchises. These banks will display either acceptable financial fundamentals within a predictable and stable operating environment, or good financial fundamentals within a less predictable and stable operating environment.

Note: The definitions for Moody's Bank Financial Strength Ratings employ the alphabetic notation A through E as well as the symbols + and - to indicate gradation.

Fitch – Support Rating

1 denotes:

A bank for which there is an extremely high probability of external support. The potential provider of support is very highly rated in its own right and has a very high propensity to support the bank in question. This probability of support indicates a minimum Long-term Rating floor of 'A-'.

2 denotes:

A bank for which there is a high probability of external support. The potential provider of support is highly rated in its own right and has a high propensity to provide support to the bank in question. This probability of support indicates a minimum Long-term Rating floor of 'BBB-'.

3 denotes:

A bank for which there is a moderate probability of support because of uncertainties about the ability or propensity of the potential provider of support to do so. This probability of support indicates a minimum Long-term Rating floor of 'BB-'.

Appendix 2 – Building Society Assets and Ratings

The following table shows all societies with assets in excess of £1bn (as at 31/12/2006 which is latest available) and whether they are rated by the three rating agencies. Societies with assets below £1bn do not have any ratings.

Rank	Name	Fitch	Moody's	S & P	Assets (£)
1	Nationwide Building Society	X	X	X	118,228,300
2	Britannia Building Society	X	X	X	30,644,500
3	Portman Building Society	X	X		21,254,600
4	Yorkshire Building Society	X	X	X	18,861,886
5	Coventry Building Society	X	X		12,280,800
6	Chelsea Building Society	X	X		11,080,386
7	Skipton Building Society	X	X		10,112,779
8	Leeds Building Society		X		8,142,229
9	West Bromwich Building Society	X	X		6,604,400
10	Derbyshire Building Society		X		6,019,000
11	Principality Building Society		X		4,812,296
12	Cheshire Building Society	X	X		4,706,000
13	Newcastle Building Society	X	X	X	4,296,860
14	Norwich & Peterborough Building Society		X		3,671,167
15	Stroud & Swindon Building Society				2,804,016
16	Dunfermline Building Society				2,744,894
17	Nottingham Building Society		X		2,617,155
18	Scarborough Building Society				1,735,307
19	Kent Reliance Building Society				1,614,831
20	Progressive Building Society				1,332,980
21	Cumberland Building Society				1,187,127
22	National Counties Building Society				1,032,978