CAB2284
FOR DECISION
WARD(S): GENERAL

CABINET - 8 FEBRUARY 2012

THE OVERVIEW AND SCRUTINY COMMITTEE - 13 FEBRUARY 2012

TREASURY MANAGEMENT STRATEGY 2012/13 AND 2011/12 REVISION

REPORT OF HEAD OF FINANCE

Contact Officer: Alan Goard Tel No: 01962 848117

Email: agoard@winchester.gov.uk

RECENT REFERENCES:

CAB2117 Treasury Management Strategy 2011/12, 9 February 2011

AUD011 Treasury Management Stewardship Report for 2010/11, 26 Sept. 2011

AUD015 Treasury Management Mid-Year Review 2011/12, 5 December 2011

AUD020 Treasury Management Strategy 2011/12 - Implications of Housing Finance reform, 5 December 2011

CAB2287 Housing Revenue Account Budget 2012/13 and Business Plan 2012/13 to 2042/43, 1 February 2012

EXECUTIVE SUMMARY:

This report outlines the Council's prudential indicators for 2012/13 – 2014/15 and sets out the expected treasury operations for this period. It also amends those 2011/12 prudential indicators to enable the Council to discharge its financial responsibilities in respect of the Housing Finance Reform (CAB2287 February 2012 refers). It fulfils four key reports required by the Local Government Act 2003:

1. The reporting of the **Prudential Indicators** setting out the expected capital activities, as required by the CIPFA Prudential Code for Capital Finance in Local Authorities. The treasury management prudential indicators are now included as treasury indicators in the CIPFA Treasury Management code of practice;
2. The **Treasury Management Statement**, which sets out how the Council's

treasury service will support the capital decisions taken above, in accordance with the CIPFA Code of Practice on Treasury Management;

3. The **Investment Strategy**, which sets out the Council's criteria for choosing investment counterparties and limiting exposure to risk ; and
4. The **Minimum Revenue Provision** Statement in accordance with DCLG Statutory Guidance.

CIPFA revised and reissued the Treasury Management and Prudential Guidance in November 2011. This report reflects the new guidance.

The Treasury Management Policy Statement has also been reviewed and revised, and is provided at Appendix G.

Additionally, due to the Housing Finance Reform, the Council is required to approve the approach to the allocation of loans between the Housing Revenue Account (HRA) and the General Fund (GF) and the setting of an inter-pool interest rate.

<u>RECOMMENDATIONS: to Cabinet and Council:</u>

1. That the Treasury Management Strategy 2012/13 and 2011/12 Revisions as set out in this report be approved, including:

    - the adoption of the Prudential Indicators 2011/12 to 2014/15 (see Appendix C) setting out the expected capital activities (as required by the CIPFA Prudential Code for Capital Finance in Local Government) and the Treasury Management Prudential Indicators that are now in the CIPFA Treasury Management Code of Practice;
    - A revision of the Capital Financing Requirement for 2011/12 (current year);
    - A revision to the Authorised Borrowing Limit for 2011/12;
    - Revisions to the limits on Fixed Rate & Variable Rate borrowing for 2011/12;
    - Revisions to the maturity profiles of fixed borrowing 2011/12;
    - The adoption of the "two pool" approach to accounting for HRA and GF debt and an inter-pool loan rate of PWLB 3 month variable rate be applied (see para 3);
    - the Minimum Revenue Provision (MRP) Statement which sets out the Council's policy on MRP (see para.13); and
    - the Investment Strategy 2012/13 contained in the Treasury Management Strategy.

2. That the Treasury Management Policy Statement, as set out in Appendix G, be approved.

3. That in respect of the Council's major borrowing to meet the housing requirements on 26th March, the Head of Finance will act, in conjunction with the advice of the Council's treasury advisors, and in consultation with the Portfolio Holder for Estates and Finance, on the actual borrowing on 26th March.

4. That it be noted that the Council does not intend to use derivative instruments at this stage, and that any change in this position would require full Council approval (para. 11 refers).

5. That the Strategy be kept under regular review to take account of any changes in the current global economic situation.

To The Overview and Scrutiny Committee:

1. That the Committee considers whether it wishes to make any observations or recommendations to Council on the report.

CABINET - 8 FEBRUARY 2012

THE OVERVIEW AND SCRUTINY COMMITTEE - 13 FEBRUARY 2012

TREASURY MANAGEMENT STRATEGY 2012/13 AND 2011/12 REVISION

REPORT OF HEAD OF FINANCE

1 Background

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

1.2 The purpose of this TMSS is, therefore, to approve the:

- revisions to the Treasury Management Strategy and Prudential Indicators for 2011/12
- Treasury Management Strategy for 2012/13
- Annual Investment Strategy for 2012/13
- Prudential Indicators for 2012/13, 2013/14 and 2014/15
- MRP Statement.

1.3 Treasury Management is about the management of risk. The Council is responsible for its treasury decisions and activity. No treasury management activity is without risk.

1.4 As per the requirements of the Prudential Code, the Council has adopted the CIPFA Treasury Management Code under the Constitution, Financial Procedure Rule 5.4. (CAB313, 13 February 2002 refers).

1.5 The CIPFA Prudential and Treasury guidance was updated November 2011. The Council is asked to approve the revised and amended Treasury Management Policy Statement provided at Appendix G.

1.6 All treasury activity will comply with relevant statute, guidance and accounting standards.

2 Capital Financing Requirement

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

2.2 The Council currently has no external debt and investments are set out at Appendix A.

2.3 Even before Housing Finance Reform investments are forecast to fall to a level of £4.6m at the 31 March 2012 as there is always a significant cash outflow from the Collection Fund in February and March. There are also significant cash balance fluctuations within a month which have to be managed within the Investment Strategy. Appendix B illustrates the cash and investment profile of the Council for the 12 months to 25 January 2012.

2.4 The Council is able to borrow funds in excess of the current level of its CFR up to the projected level in 2014/15. The Council is only likely to borrow in advance of need if it is felt that the benefits of borrowing at interest rates now compared to where they are expected to be in the future, outweighs the current cost and risks associated with investing the proceeds until the borrowing is actually required.

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

Table 1: Balance Sheet Summary Analysis

Forecast as at the end of:	2011/12 Original £m	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m	2104/15 Estimate £m
General Fund CFR	3.8	(1.4)	4.5	4.2	3.9
HRA CFR	10.1	** 166.8	166.8	166.8	166.8
Total CFR	13.9	165.4	171.3	171.0	170.7
Less: Existing Profile of Borrowing and Other Long Term Liabilities	0.0	156.7	156.7	156.7	156.7
Cumulative Maximum External Borrowing Requirement	**13.9**	**8.7**	**14.6**	**14.3**	**13.3**
Usable Reserves & working capital	10.2	13.3	11.1	10.1	9.1
Cumulative Net Borrowing Requirement/(Investments)	**3.7**	**(4.6)**	**3.5**	**4.2**	**4.2**

**this figure reflects the increase on account of Housing Finance Reform.

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

3 Self-Financing of Housing

3.1 The Housing Finance Reforms involve the removal of the housing subsidy system by offering a one-off reallocation of debt. The Settlement Payments Determination 2012 has now been issued. It has effect from 28th March 2012.

3.2 A self-financing valuation of each local housing authority's council housing stock has been made using a discounted cash flow model of each authority's social housing business. This model is based on assumptions made by Government about the rental income and expenditure required to maintain each council's council housing stock over 30 years and will result in the Council having to take on debt in order to make the settlement payment of **£156.722m**.

3.3 This is clearly a significant issue for the Council and in recognition of this a cross party Housing Self-Financing Informal Policy Group (IPG) was established with the following Terms of Reference:

To consider the options available to the Council for financing the payment to DCLG in March 2012 in respect of the Housing Finance Reform and to present options/ recommendations to the Cabinet on the borrowing and repayment strategy, reflecting the considered level of acceptable risk.

3.4 The Members of the IPG were: Cllrs. Coates, Beckett, Learney, Pines, Thompson and Wood. They met on two occasions and were supported by officers and the Treasury Management Advisors, Arlingclose.

3.5 A summary of the Group's considerations was included in a report to Cabinet (Housing) Committee in January, an extract of which is provided at Appendix H. The recommendations of the IPG are fully reflected in the proposals now presented in this report.

3.6 The IPG agreed the following key principle:

That the profile of debt should be planned to support the investment needs of the Housing Business Plan, whilst ensuring the ability of the HRA to service the debt.

3.7 Because the payment is required to be made on 28th March 2012 – before self financing for the HRA comes into effect on 1st April 2012, the HRA will receive compensation for the additional interest costs arising. A "**Variation of the housing revenue account subsidy determination 2011-12"** has been issued by CLG as follows:

*"The interest on the self-financing settlement payment is **£56,180** being an adjustment to the Council's subsidy entitlement to take account of interest charges occasioned by the implementation of sections 167 to 175 of the Localism Act 2011"*

However, any transaction costs in relation to borrowing to fund the payment will be borne by the HRA. These are estimated to be in the region of £50k.

3.8 The Secretary of State has set a limit on the amount of housing debt that each authority can hold. The Council's **Limit on Indebtedness** has been set at **£166.853m.** This is reflected in the relevant Prudential Indicator at Appendix C, para. 14.

3.9 The Audit Committee were advised in December of the changes that would be required to the Prudential Indicators for 2011/12 as a consequence of Housing Finance Reform (AUD020). In Appendix C revisions are made to the

Prudential Indicators for 2011/12 to reflect the introduction of borrowing in relation to the self-financing settlement.

3.10 The Government announced on 21 September 2011 that for the sole purpose of new borrowings in relation to Self Financing it would be reducing the margin above gilts used to calculate the interest rates charged by the Public Works Loan Board (PWLB). On 21 November 2011 it was announced that the special reduced rates will be available for applications received on Monday 26 March 2012 only. The availability of these special reduced rates, which are on average 13 basis points above gilt rates (and circa. 0.8% below normal PWLB rates), makes this the cheapest source of funding available to the Council.

In consideration of this the Housing Self – Financing Informal Policy Group supported the recommendations that, in relation to the housing settlement payment, the Council does not take any borrowing in advance of the settlement date, and that the Council borrows up to the value of the settlement at the special rates available only for housing settlements, from the PWLB on 26 March.

3.11 The approvals within this document reflect the considerations of the IPG. However the actual specific borrowing amounts and terms for the Council's major borrowing to meet the housing requirements can only be determined on 26th March when it is known what rates are available. This will be conducted in accordance with the delegation within the Treasury Management Policy (Appendix G) which gives responsibility for the execution and administration of treasury management decisions to the Head of Finance, who will act in accordance with the organisation's policy statement and TMPs and CIPFA's Standard of Professional Practice on Treasury Management. However, because of the significance of this transaction to the Council, on this occasion the Head of Finance will act, in conjunction with the advice of the Council's treasury advisors, and in consultation with the Portfolio Holder for Estates and Finance, on the actual borrowing on 26th March.

Accounting

3.12 As a consequence of the abolition of the housing subsidy system in April 2012 the Council will need to take on additional borrowing and will need to agree a methodology for allocating existing and future borrowing costs between housing and the General Fund, as the current statutory method of apportioning debt charges between the General Fund and the HRA will cease.

3.13 The CIPFA Treasury code sets out the principles upon which the allocation of loans should be based:-

- The underlying principle for the splitting of loans, at transition, must be that of no detriment to the General Fund.
- Local authorities are required to deliver a solution that is broadly equitable between the HRA and the General Fund.
- Future charges to the HRA in relation to borrowing are not influenced by General Fund decisions, giving a greater degree of independence, certainty and control.
- Un-invested balance sheet resources which allow borrowing to be below the CFR are properly identified between General Fund and HRA.

3.14 The methodology for splitting loans to meet the requirements of the new system has not been imposed by the Government in legislation; it is for authorities to adopt their own appropriate methods, provided that they achieve the principles detailed in their treasury management strategies approved by their full council.

3.15 The CIPFA guidance sets out a proposed methodology for attributing loans to the HRA for accounting purposes but stipulates that:

"It should be remembered that the loans themselves remain a debt of the overall authority and the government will not be requiring the PWLB to separate loans at source. All loans are charged indifferently on all the revenues of the authority in accordance with the 2003 Act, and all loans have the benefit of the 'safe harbour' provision, which means that lenders do not need to enquire whether the authority has power to borrow the money and shall not be prejudiced by the absence of any such power.
It should also be remembered that the section 151 officer retains overall responsibility for treasury management in an authority, which includes debt management."

3.16 The proposed solution offered in the CIPFA Treasury Management Code of Practice is: "**Two Loans Pools (General Fund and HRA)**". This is further explained as follows:

Where the HRA takes on unfunded CFR, the choice is to take on additional borrowing to fully borrow up to the level of HRACFR or to retain unfunded CFR and pay interest to General Fund in line with the policy on interest on balances. This choice will need to be exercised on the basis of the authority's overall cash flows and treasury and investment policies and strategies.

In order to ensure equity, all types of loans should be split between the HRA and General Fund. It is recognised that this will have practical implications, but as the General Fund and the HRA are likely to have different optimum maturity profiles and restructuring requirements in order to manage their treasury management risks, it is likely to be the preferred long-term solution.

3.17 The HRA does currently have a Capital Financing Requirement which is funded by “internal” borrowing from the General Fund. The PWLB special rates are not available to the HRA for this element of borrowing. Therefore, whilst funds are available, continuing with this internal borrowing/lending arrangement is beneficial to both funds and minimises both costs and risks to the Council.

The Housing Self- Financing IPG supported the recommendation that the HRA continues to “borrow” £10.13m from the General Fund until such time as the Council has an overall need to externally borrow.

3.18 The practicalities of this approach are that the new loans are allocated to the HRA pool, reserves and balances will be identified between HRA and General Fund. This will result in a notional loan balance between the two pools, which is currently budgeted to be HRA owes the General Fund, but as HRA balances increase as expected and General Fund unfunded capital expenditure takes place, it is possible that either both pools have balances to invest, or even the General Fund will borrow from HRA

3.19 The Council is asked to approve the two pool approach and to set the inter pool loan rate at the PWLB 3 month variable loan rate (Indicative figure 1.49% at 6 February).

4 Interest Rate Forecast

4.1 The economic and interest rate forecast provided by the Council’s treasury management advisor is attached at Appendix D. The Council will reappraise its strategies from time to time in response to evolving economic, political, and financial events.

5 Borrowing Strategy

5.1 Treasury management and borrowing strategies in particular continue to be influenced not only by the absolute level of borrowing rates but also the relationship between short and long term interest rates. The interest rate forecast provided in Appendix D indicates that an acute difference between short and longer term interest rates is expected to continue. This difference creates a “cost of carry” for any new longer term borrowing where the proceeds are temporarily held as investments because of the difference between what is paid on the borrowing and what is earned on the investment. Whilst the cost of carry can be assumed to be a reasonably short-term issue since borrowing is often for longer dated periods (anything up to 50 years) it cannot be ignored against a backdrop of uncertainty and affordability constraints in the Council’s wider financial position.

5.2 As indicated in Table 1, the Council has a gross and net borrowing requirement and will be required to borrow up to £156.722 in 2011/12 and a further £3.5m in 2012/13. The Council will adopt a flexible approach to this borrowing in consultation with its treasury management advisers, Arlingclose Ltd. The following issues will be considered prior to undertaking any external borrowing:

- Affordability;
- Maturity profile of existing debt;
- Interest rate and refinancing risk;
- Borrowing source.

6 Sources of Borrowing and Portfolio implications

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

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

6.2 The Council’s exposure to shorter dated and variable rate borrowing will be kept under regular review by reference to the difference or spread between variable rate and longer term borrowing costs. A narrowing in the spread by 0.5% will result in an immediate and formal review of the borrowing strategy to determine whether the exposure to shorter dated and variable rates is maintained or altered.

7 Debt Rescheduling

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

7.2 The rationale for undertaking any debt rescheduling would be one or more of the following:

- Savings in risk adjusted interest costs
- Rebalancing the interest rate structure of the debt portfolio
- Changing the maturity profile of the debt portfolio

7.3 Borrowing and rescheduling activity will be reported in the Annual Treasury Management Report and the regular treasury management reports presented to the Audit Committee.

8 Annual Investment Strategy

8.1 In accordance with Investment Guidance issued by the CLG and best practice this Council's primary objective in relation to the investment of public funds remains the security of capital. The liquidity or accessibility of the Council's investments followed by the yields earned on investments is important but are secondary considerations.

8.2 Credit markets remain in a state of distress as a result of the excessive and poor performing debt within the financial markets. In some instances, Greece and Italy being the most notable examples, the extent and implications of the debt it has built up have lead to a sovereign debt crisis and a banking crisis with the outcome still largely unknown. It is against this backdrop of uncertainty that the Council's investment strategy is framed.

8.3 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.

8.4 The types of investments that will be used by the Council, whether they are specified or non-specified and the limits to be applied are as follows:

Table 2: Specified and Non-Specified Investments

Investment	Specified	Non-Specified	Counterparty Limit
Term deposits with banks and building societies	✓	✓	£2m+See appendix E
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

8.5 A number of changes are to be implemented to investment strategy for 2012/13 in response bringing the Council more in line with the Arlingclose, new treasury consultants' approach. The limits on Bank and Building Society are raised from £1m to £2m but with an additional limit of 15% of total funds invested. Arlingclose have advised the Council to open a custody account so that it could invest in treasury bills which usually give a higher return than the Debt Management Account Deposit Facility. The Council could also use the same facility to hold Gilts, Certificates of Deposit and Bonds.

8.6 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.

The institutions that meet the criteria for term deposits, Certificates of Deposit (CDs) and call accounts are included in Appendix E.

It remains the Council's policy to make exceptions to counterparty policy established around credit ratings, but this is conditional and directional. What this means is that an institution that meets criteria may be suspended, but institutions not meeting criteria will not be added.

8.7 **Council's Banker** – The Council banks with National Westminster. At the current time, it meets the minimum credit criteria of A- (or equivalent) long term. Even if the credit rating falls below the Council's minimum criteria NatWest will continue to be used for short term liquidity requirements (overnight and weekend investments) and business continuity arrangements. As now, the **limit for NatWest will be £3m with an additional £1m with daily** approval by the Head of Finance.

9 Investment Strategy

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

9.2 In order to diversify an investment portfolio largely invested in cash, investments will be placed with a range of approved investment counterparties in order to achieve a diversified portfolio of prudent counterparties, investment periods and rates of return. Maximum investment levels with each counterparty will be set to ensure prudent diversification is achieved.

9.3 Money Market Funds (MMFs) will be utilised but good treasury management practice prevails and whilst MMFs provide good diversification the Council will also seek to diversify any exposure by utilising more than one MMF. The

Council will also restrict its exposure to MMFs with a limit of £2m per fund and will not exceed 0.5% of the net asset value of the MMF.

9.4 It should be noted that as the Council's investment balances reduce, greater use of money market funds is expected to enable the Council to manage its monthly cash cycle of approximately £12m (see Appendix B). However, only two AAA money market funds are domiciled in the UK, so it will be necessary to use money market funds that are domiciled abroad (see Appendix F for more information).

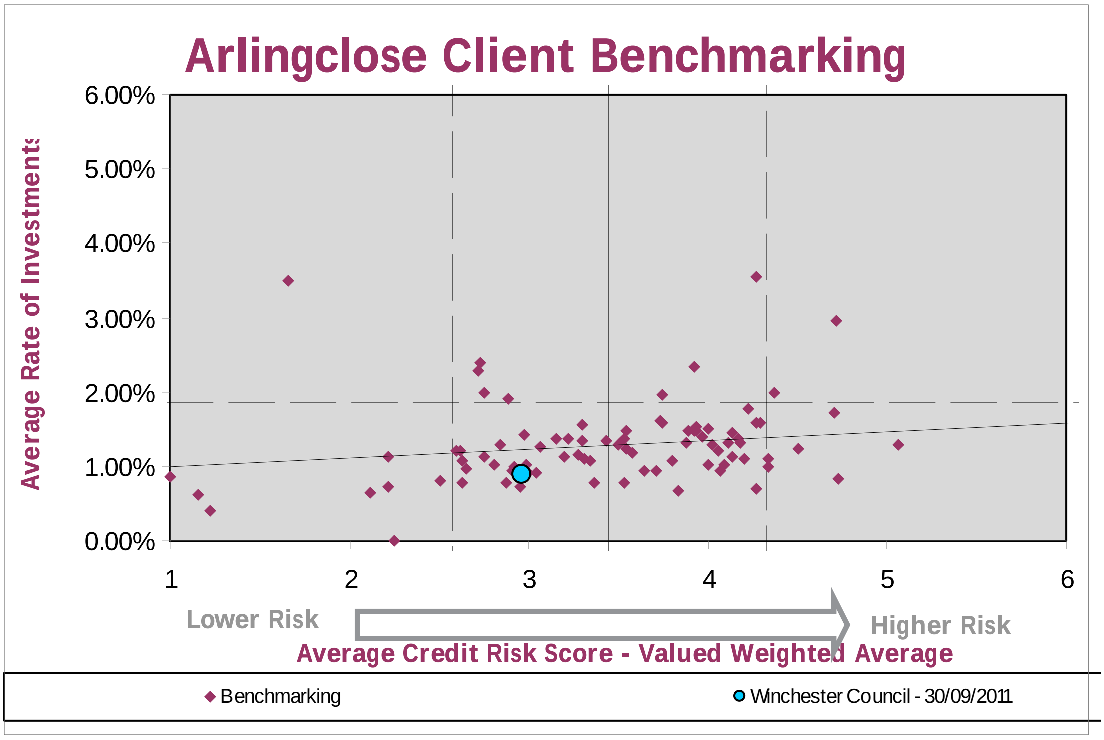
Collective Investment Schemes (Pooled Funds)

9.5 The Council currently holds 422,654 units in the Local Authorities Mutual Investment Trust – Property Fund. The performance and continued suitability in meeting the Council's investment objectives are regularly monitored.

10 Measurement and management of investment risk

10.1 The Council's treasury management consultants carry out a quarterly benchmarking exercise which allocates a credit risk score based on credit ratings and compares the Council with other public sector clients.

Report at September 2011



AAA = 1, A- =7

The score has moved as follows:

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating	Time Weighted Average – Credit Risk Score	Time Weighted Average – Credit Rating
13/04/2011	3.84	AA-	4.32	AA-
30/06/2011	3.77	AA-	3.06	AA
16/09/2011	2.94	AA	2.86	AA

This reflects a tightening of Counterparty criteria as market conditions have deteriorated.

10.2 This information forms the basis of a quarterly review meeting with Arlingclose where the risk profile of the Council's portfolio is considered in the context of current and forecast market developments. This is in addition to any daily specific counterparty updates.

11 The Use of Financial Instruments for the Management of Risks

11.1 Currently, Local Authorities' legal power to use derivative instruments remains unclear. The General Power of Competence enshrined in the Localism Act is not sufficiently explicit. Consequently, the Council does not intend to use derivatives.

11.2 Should this position change, the Council may seek to develop a detailed and robust risk management framework governing the use of derivatives, but this change in strategy would require full Council approval.

12 Balanced Budget Requirement

12.1 The Council complies with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget.

13 2012/13 MRP Statement

13.1 The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (SI 2008/414) place a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision (MRP) has been issued by the Secretary of

State and local authorities are required to "have regard" to such Guidance under Section 21(1A) of the Local Government Act 2003.

13.2 This relates to non-HRA capital expenditure only. There is no requirement to charge MRP in respect of HRA capital expenditure funded from borrowing.

13.3 There are four MRP options available:
- Option 1: Regulatory Method
- Option 2: CFR Method
- Option 3: Asset Life Method
- Option 4: Depreciation Method

N.B. This does not preclude other prudent methods.

13.4 MRP in 2012/13: Options 1 and 2 may be used only for supported (i.e. financing costs deemed to be supported through Revenue Support Grant from Central Government) Non-HRA capital expenditure funded from borrowing. Methods of making prudent provision for unsupported Non-HRA capital expenditure include Options 3 and 4 (which may also be used for supported Non-HRA capital expenditure if the Council chooses).

13.5 The Council is recommended to approve the following MRP Statement:-

The Council will apply Option 3: The Asset Life Method, MRP will be based on estimated life of the assets charged on an equal instalment basis, in accordance with the regulations, in respect of supported and unsupported Non-HRA capital expenditure funded from borrowing.

And:

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

14 Monitoring and Reporting on the Treasury Outturn and Prudential Indicators

14.1 The Head of Finance will report to the Audit Committee on treasury management activity/performance and Performance Indicators as follows:
- Half yearly against the Strategy approved for the year. The Council will produce an outturn report on its treasury activity no later than 30th September after the financial year end.

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

15 Other Items

15.1 Training

CIPFA’s Code of Practice requires the responsible officer to ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

Reviewing and addressing training needs is undertaken by the Head of Finance on an annual basis.

15.2 Investment Consultants/Treasury Advisors

The Council’s Treasury Management consultants are Arlingclose. The company provides a range of services which include

(i) Technical support on treasury matters, capital financing issues and the drafting of members' reports.
(ii) Economic and interest rate analysis.
(iii) Debt services which includes advice on the timing of borrowing
(iv) Investment advice on counterparties, timing and investment instruments.

Whilst the advisors provide support to the internal treasury function under CIPFA code of Practice the final decision on treasury matters remains with the Council.

The service is subject to regular review meetings.

15.3 Investment in Heritable Bank Ltd (in Administration)

On 16 September 2008 the Council invested £1m in Heritable Bank for a period of 6 months at a rate of 6%. Heritable is a Scottish registered company and a 100% subsidiary of (Old) Landsbanki.

To date the Council has received £681,563 distributions from the Administrator including £178,760 in this financial year. The next distribution is expected in April 2012.

The current forecast is that the Council will recover a further £198,000 by January 2013 making an 88% recovery of the original investment.

OTHER CONSIDERATIONS:

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

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

17. RESOURCE IMPLICATIONS:

The continued low interest rates continue to have a significant impact on the Investment Income budget; for 2012/13 this is £67k; 4 years ago this was £1m. Base rate is forecast to remain at 0.5% throughout to 31 March 2015, the time horizon of this report. A 0.1% change in interest rates would alter investment income by £13k.

Given that the Council needs to borrow to make the settlement payment of £156,722,000 in respect of Housing Finance Reform the historically low, and continuing low interest rates are of benefit to the Council, a 0.1% change in interest rates equals £156,722

18 RISK MANAGEMENT ISSUES

These are considered within the report.

BACKGROUND DOCUMENTS:

- Operational and financial records held in the Finance Team

- Constitution and Financial Procedure Rules

- Communities and Local Government has today published the following **final** self-financing determinations:

• **The Settlement Payments Determination** - This sets out the amount each local authority will either pay the Government or receive from the Government on 28 March 2012 in order to exit the current subsidy system, and the way in which the payments will be made.
• **The Limit on Indebtedness Determination -** This places a cap on the amount of housing debt each council may hold.
• **The Housing Revenue Account Subsidy Amendment Determination for the year 2011-12** - This adjusts the subsidy entitlement for this financial year in order to take account of the interest costs or savings arising from the settlement payments. These payments will be made before the end of the financial year.
• **The Item 8 Credit and Debt Amendment Determination for the year 2011-12 -** This enables the appropriate charges to be made between the Housing

Revenue Account and a council's General Fund to reflect the borrowing costs or savings in this financial year arising from the settlement payments.

- **The Item 8 Credit and debit Determinations for 2012 onwards** - This provides a framework for the Housing Revenue Account ring-fence to continue to operate under self-financing.

CLG has also published the final spreadsheet model, detailing the final settlement amounts. For authorities making a payment to CLG, there is also a note on procedures to be followed on the transaction date.

The documents and further information can be accessed through the following link:
http://www.communities.gov.uk/publications/housing/selffinancingdeterminations

- PWLB are putting in place a website, with appropriate safeguards, where authorities can input details of the loans they require during March and finalise their loan applications on 26 March. See www.dmo.gov.uk/selffinancing for more details, including a timetable.

APPENDICES:

Appendix A Investments at 31 December 2011

Appendix B Daily Cash & Short Term Investment Balances 2010/11

Appendix C Prudential Indicators: 2011/12 – 2014/15

Appendix D Economic & Interest Rate Forecast

Appendix E Current UK Institutions that meet minimum investment criteria

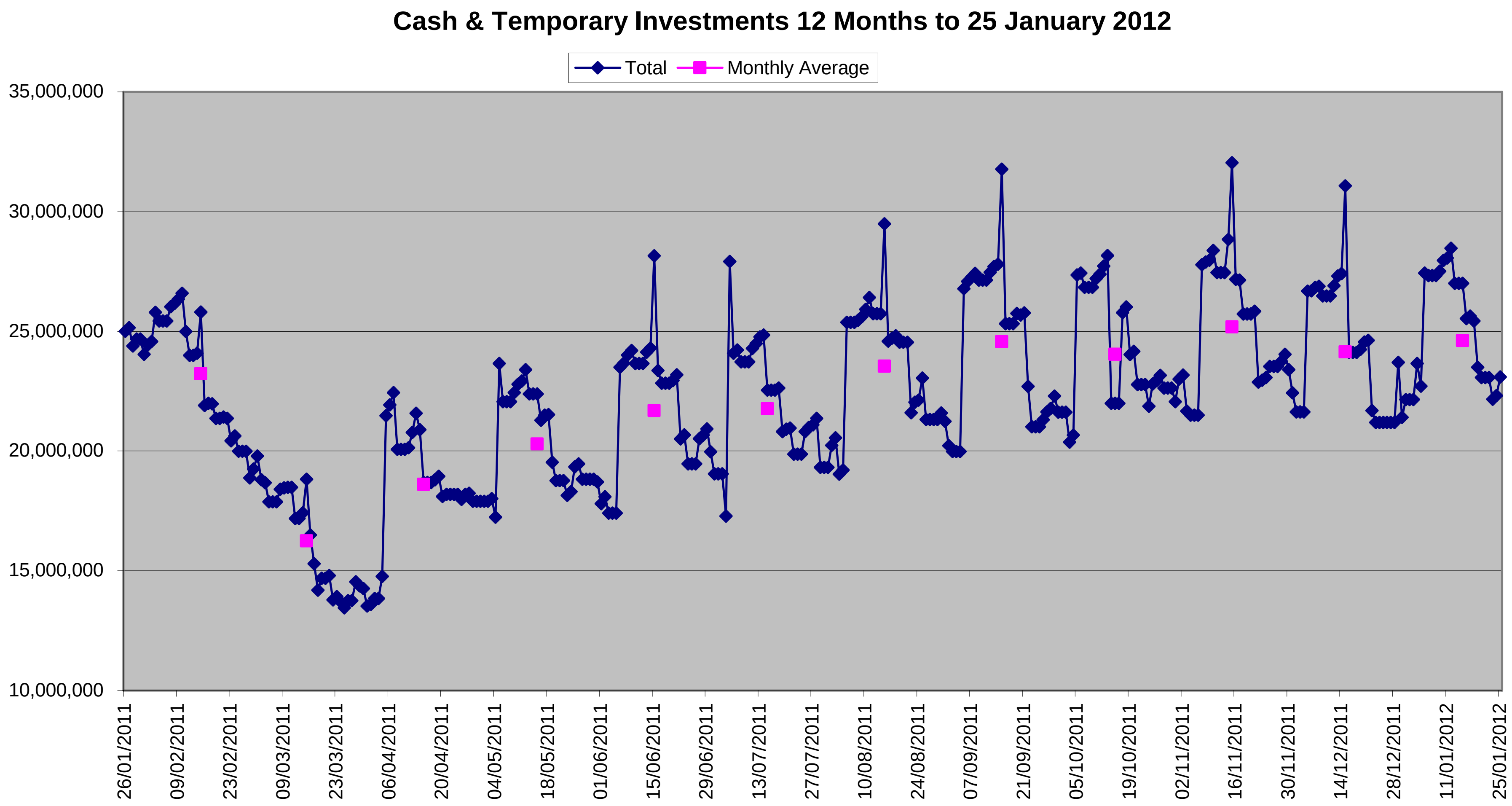
Appendix F Money Market Funds Domiciled Abroad

Appendix G Treasury Management Policy

Appendix H Housing Self Financing Informal Policy Group – extract from CAB2287

Appendix I Housing Debt – Risk Analysis (by Arlingclose)

Investments & Bank as at	31 December 2011			
Tier 1: UK Government	**£**	**Maturity Date**	**Term (days)**	**Weighted Ave Rates %**
Debt Management Office	1,600,000	various		0.25
Local Authorities: Salford City Council	2,000,000	10/02/2012	189	0.50
Local Authorities: Lancashire County Council	2,000,000	16/03/2012	282	0.80
Local Authorities: Aberdeen City Council	2,000,000	09/03/2012	156	0.48
Local Authorities: Birmingham City Council	2,000,000	09/01/2012	94	0.40
Local Authorities: Redditch Borough Council	1,000,000	16/03/2012	262	0.75
Local Authorities: Dundee City Council	2,000,000	16/02/2012	226	0.75
Local Authorities: Greater Manchester Police Authority	1,000,000	05/01/2012	51	0.32
AAA Money Market Funds				
Prime Rate MMF	1,500,000			0.90
Total Tier 1	**15,100,000**			**0.57**
Tier 2: UK Banks with significant Government Shareholdings				
National Westminster Bank - Current Account	2,057,070			0.80
Bank of Scotland Term Deposit (Lloyds Bank Group)	1,000,000	05/01/2012	364	2.40
Northern Rock Plc	2,000,000	16/02/2012	226	1.18
Total Tier 2	**5,057,070**			**1.27**
Tier 3: A Rated UK Banks eligible institutions of the 2008 Credit Guarantee Scheme				
Barclays	1,000,000	06/03/2012	274	1.29
Total Tier 3	**1,000,000**			**1.29**
Tier 4: A Rated UK Building Societies eligible institutions of the 2008 Credit Guarantee Scheme				
Nationwide	1,000,000	16/03/2012	284	1.18
Total Tier 4	**1,000,000**			**1.18**
All Short Term Funds	**22,157,070**			**0.79**
Long Term Investments				
Local Authorities Mutual Investment Trust	1,000,000			5.28
Total Bank & Investments	**23,157,070**			**0.99**
Impaired Investments				
Heritable Bank Ltd in Administration (Original Investment)	351,793			


Cash & Temporary Investments 12 Months to 25 January 2012
Total
Monthly Average
35,000,000
30,000,000
25,000,000
20,000,000
15,000,000
10,000,000
26/01/2011
09/02/2011
23/02/2011
09/03/2011
23/03/2011
06/04/2011
20/04/2011
04/05/2011
18/05/2011
01/06/2011
15/06/2011
29/06/2011
13/07/2011
27/07/2011
10/08/2011
24/08/2011
07/09/2011
21/09/2011
05/10/2011
19/10/2011
02/11/2011
16/11/2011
30/11/2011
14/12/2011
28/12/2011
11/01/2012
25/01/2012

Prudential Indicators - Revisions to 2011/12 and 2012/13 – 2014/15

Note: Revisions are being made to the 2011/12 Prudential Indicators as a result of HRA Subsidy Reform, in particular the Capital Financing Requirement, the Authorised Limit and Operational Boundary and the associated treasury PIs.

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

2. Net Borrowing and the 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 local 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 Head of Finance reports that the Council will have no difficulty meeting this requirement in 2011/12, 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.

3. Estimates of Capital Expenditure:

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

Capital Expenditure	**2011/12 Approved**	**2011/12 Revised**	**2012/13 Estimate**	**2013/14 Estimate**	**2014/15 Estimate**
	£million	**£million**	**£million**	**£million**	**£million**
Non-HRA	14.1	9.0	9.4	1.8	2.2
HRA	6.5	161.6	10.6	10.6	10.6
Financed by:					
Non - HRA					
Government grants	0.4	0.4	0.4	0.4	0.4
External contributions	0.8	1.1	0.8	0.5	0.1
Earmarked reserves	0.4	0.8	0.7	0.6	0.5
Major Investment reserve	0.8	0.9	0.6	0.2	0.1
Capital receipts	2.1	1.2	0.8	0.1	1.1

Capital Expenditure	2011/12 Approved £million	2011/12 Revised £million	2012/13 Estimate £million	2013/14 Estimate £million	2014/15 Estimate £million
HRA					
Major Repairs Reserve	3.9	4.3	3.9	3.9	3.9
Revenue Reserves	0.1	0.3	6.0	6.6	5.6
Capital Receipts	2.5	0.3	0.7	0.1	1.1
Net financing need for the year	**9.6**	**161.3**	**6.1**	**0.0**	**0.0**

4. Ratio of Financing Costs to Net Revenue Stream:

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

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

Affordability Indicator	2011/12 Approved %	2011/12 Revised %	2012/13 Estimate %	2013/14 Estimate %	2014/15 Estimate %
Non-HRA	0.5	(1.1)	(0.0)	1.3	1.5
HRA	0.3	0.5	23.3	22.6	22.0

5. Capital Financing Requirement:

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

	2011/12 Approved £million	2011/12 Revised £million	2012/13 Estimate £million	2013/14 Estimate £million	2014/15 Estimate £million
Capital Financing Requirement					
CFR – Non Housing	3.8	(1.5)	4.4	4.1	3.8
CFR - Housing	10.1	10.1	166.9	166.9	166.9
Total CFR	**13.9**	**8.6**	**171.3**	**171.0**	**170.7**

6. Actual External Debt:

6.1 This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

Actual External Debt as at 31/03/2011	£m
Borrowing	0
Other Long-term Liabilities	0
Total	**0**

7. Incremental Impact of Capital Investment Decisions:

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

	2011/12 Approved £	2012/13 Estimate £	2013/14 Estimate £	2014/15 Estimate £
Increase/(Decrease) in Council Tax - Band D	(1.74)	11.03	12.08	14.93
Increase Weekly Housing Rent levels	0.03	24.90	27.72	23.70

7.2 The increase in costs to the General Fund/Council Tax are due to a change in strategy in that annual recurring costs such as Disabled Facilities Grant and IT are being funded from revenue. This reflects the run down of usable capital and revenue reserves over previous years.

7.3 The increase on the HRA is due to the ending of the HRA subsidy system which has created significant addition revenue surpluses that the Council intends to use to fund backlog refurbishment and the creation of new Housing stock.

8. Authorised Limit and Operational Boundary for External Debt:

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

8.2 The **Authorised Limit** sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities. This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Council’s existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.

8.3 The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.

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

Authorised limit £m	2011/12 Approved	2011/12 Revised	2012/13 Estimated	2013/14 Estimated	2014/15 Estimated
Borrowing	13.9	177.3	183.3	183.0	182.7
Other long term liabilities	0.0	5.0	5.0	5.0	5.0
Total	**13.9**	**182.3**	**188.3**	**188.0**	**187.7**

The revision to borrowing is caused by the payment for the Housing Finance Reform. The payment date to DCLG is 28 March 2011. The addition to other long term liabilities is to cover issues involving embedded leases resulting from the new joint environmental services contract with East Hampshire District Council.

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

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

Operational Boundary £m	2011/12 Approved	2011/12 Revised	2012/13 Estimated	2013/14 Estimated	2014/15 Estimated
Borrowing	8.9	172.3	178.3	178.0	177.7
Other long term liabilities	0.0	3.0	3.0	3.0	3.0
Total	**8.9**	**175.3**	**181.3**	**181.0**	**180.7**

9. Adoption of the CIPFA Treasury Management Code:

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

Adoption of the CIPFA Code of Practice in Treasury Management
The Council adopted the CIPFA Treasury Management Code under the Constitution, Financial Procedure Rule 5.4 (CAB313, 13 February 2002 refers)

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

10. Gross and Net Debt

This is a new indicator to highlight where an authority may be borrowing in advance of need. However, it is currently under review.

Gross borrowing is assumed to be the operational boundary and investments are the projected investments at the year end (see Appendix B - this is the cash low point of the Council).

	2011/12 Approved	2011/12 Revised	2012/13 Estimated	2013/14 Estimated	2014/15 Estimated
Net Debt as a percentage of Gross Debt	N/A	97.3%	100.0%	100.0%	100.0%

It is the Council's intention to borrow in advance of need in the short term. The benefit is that the Council secures funding at the special low PWLB rate which is only available for the Housing Finance Reform, at a discount of 0.8%. This situation is forecast to last less than one year by which time the unfunded General Fund capital programme will have taken place, requiring the HRA to repay what it has temporarily borrowed from General Fund. The investment counterparty risk will be managed as set out in the Investment Strategy section of the main report**.**

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

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

	Existing level 1 31/03/11 %	2011/12 Approved £m or %	2011/12 Revised £m or %	2012/13 Estimate £m or %	2013/14 Estimate £m or %	2014/15 Estimate £m or %
Upper Limit for Fixed Interest Rate Exposure	N/A	100%	100%	100%	100%	100%
Upper Limit for Variable Interest Rate Exposure	N/A	100%	39%	64%	66%	66%

Interest Rate Exposures	Existing level 31/03/11 %	2011/12 Approved £m/%	2011/12 Revised £m/%	2012/13 Estimate £m/%	2013/14 Estimate £m/%	2014/15 Estimate £m/%
Fixed						
Upper Limit for Fixed Interest Rate Exposure on Debt	N/A	100%	100%	100%	100%	100%
Upper Limit for Fixed Interest Rate Exposure on Investments	0%	100%	0%	0%	0%	0%
Net Debt Fixed Exposure	**N/A**	**100%**	**100%**	**100%**	**100%**	**100%**
Variable						
Upper Limit for Variable Interest Rate Exposure on Debt	N/A	100%	20%	20%	20%	20%
Upper Limit for Variable Interest Rate Exposure on Investments	100%	£5m	100%	100%	100%	100%
Net Debt Variable Exposure	**N/A**	**100%**	39%	64%	66%	66%

Note it is considered that any fixed term borrowing or investment for less than one year is considered to be variable as it will have to be renewed during the year

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

11. Maturity Structure of Fixed Rate borrowing:

11.1 This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years. Note the 2011/12 revisions that are required to fund the Housing reform.

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

Maturity structure of fixed rate borrowing	Existing level at 31/03/11 %	Authorised Lower Limit 2011/12 £m	Authorised Upper Limit 2011/12 £m	Revised Lower Limit 2011/12 £m	Revised Upper Limit 2011/12 £m	Lower Limit 2012/13 £m	Upper Limit 2012/13 £m
12 months and within 24 months	0%	0.0	5	0.0	20.0	0.00	20.0
24 months and within 5 years	0%	0.0	5	0.0	40.0	0.00	40.0
5 years and within 10 years	0%	0.0	5	0.0	60.0	0.00	60.0
10 years and within 20 years	0%	0.0	5	0.0	120.0	0.00	120.0
20 years and within 30 years	0%	0.0		0.0	177.3	0.00	183.3
30 years and within 40 years	0%	0.0		0.0	177.3	0.00	183.3
40 years and within 50 years	0%	0.0		0.0	177.3	0.00	183.3
50 years and above	0%	0.0		0.0	177.3	0.00	183.3

12. Credit Risk:

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

12.2 Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Council's assessment of counterparty credit risk.

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

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

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

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

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

Upper Limit for total principal sums invested over 364 days	2011/12 Approved £m	2011/12 Revised £m	2012/13 Estimate £m	2013/14 Estimate £m	2014/15 Estimate £m
	2.0	2.0	2.0	2.0	2.0

14. HRA Limit on Indebtedness

HRA Limit on Indebtedness	2011/12 Approved £m	2011/12 Revised £m	2012/13 Estimate £m	2013/14 Estimate £m	2014/15 Estimate £m
HRA CFR	10.1	10.1	166.9	166.9	166.9
HRA Debt Cap (as prescribed by CLG)	N/A	N/A	166.9	166.9	166.9
Difference			0.0	0.0	0.0

ECONOMIC AND INTEREST RATE FORECAST

	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
Official Bank Rate													
Upside risk						0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**
Downside risk													
1-yr LIBID													
Upside risk	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**1.75**	**1.75**	**1.75**	**1.75**	**1.75**	**1.80**	**1.85**	**1.95**	**2.00**	**2.10**	**2.20**	**2.30**	**2.40**
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
5-yr gilt													
Upside risk	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**1.25**	**1.30**	**1.35**	**1.40**	**1.50**	**1.60**	**1.70**	**1.80**	**2.00**	**2.10**	**2.30**	**2.40**	**2.50**
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
10-yr gilt													
Upside risk	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**2.20**	**2.30**	**2.40**	**2.45**	**2.50**	**2.55**	**2.60**	**2.70**	**2.75**	**2.80**	**2.85**	**2.90**	**3.00**
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
20-yr gilt													
Upside risk	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**3.00**	**3.05**	**3.05**	**3.10**	**3.20**	**3.25**	**3.30**	**3.35**	**3.40**	**3.45**	**3.50**	**3.60**	**3.75**
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
50-yr gilt													
Upside risk	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**3.25**	**3.40**	**3.50**	**3.60**	**3.70**	**3.80**	**3.90**	**4.00**	**4.00**	**4.00**	**4.10**	**4.20**	**4.25**
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

- The UK's status as a safe haven remains for now and keeps Gilt yields suppressed.
- Conventional monetary policy has become largely redundant; the Bank of England and the US Federal Reserve have signalled their respective official interest rates will be on hold through to the end of 2012. We think that it could be 2016 before official interest rates rise.
- The Bank of England’s Monetary Policy Committee has returned to unconventional monetary policy and embarked on a further round of Quantitative Easing. There will be more to come.

<u>Underlying Assumptions:</u>

- Stress in financial markets continued to build. Rates within Interbank markets (where banks fund the majority of their day to day operations) continue to climb. This dynamic was a feature of the banking crisis that occurred in 2008 and whilst the authorities have flooded the markets with liquidity still provides a key barometer of rising risk within markets.
- The MPC's decision to embark on a further £75 billion of QE – which the Minutes showed was unanimously supported – is likely to be expanded in the coming months as some members of the MPC had voted for £100bn of QE.

ECONOMIC AND INTEREST RATE FORECAST

- Inflation moderated back to 5% from what is considered to be its peak of 5.2% reached in October. The Bank of England expects domestic inflation to subside markedly in 2012 as the twin effects of the VAT increase and surge in oil prices fall out of the twelve month series.
- Economic growth meanwhile remains largely illusive not helped by the considerable uncertainty and expansion of risks presented by the crisis in the Eurozone. Even if a credible and effective policy is implemented, the scale of the problems means that there is likely to be a prolonged period of subdued growth within the euro area. A failure to meet the challenges would almost certainly have significant implications for the global economy.
- Recent data and surveys suggest that the UK economy has lost the admittedly fragile momentum since the summer. Business and consumer surveys point to continued weakness in coming months and the situation in the euro area is likely to further undermine confidence and lead to tighter credit conditions for households and firms.
- Against this uncertain backdrop the ability of the economy (government, companies and individual consumers) to accommodate an increase in the cost of money through higher interest rates – in the absence of a deterioration in the high credit standing that the UK enjoys – remains unlikely. In fact, we believe that it is highly unlikely.

Group Limits: - for institutions within a banking group, the Council executes a limit of 1.5 times the individual limit of a single bank within that group

Instrument	Country/ Domicile	Counterparty	Maximum Counterparty Limit %/£m *	Maximum Group Limit (if applicable) %/£m
Term Deposits / CDs / Call Accounts	UK	Santander UK Plc (Banco Santander Group)	£2m / 15% of total investments at time of investing	
Term Deposits / CDs / Call Accounts	UK	Bank of Scotland (Lloyds Banking Group)	£3m*/ 15% of total investments at time of investing	£5m/ 15% of total investments at time of investing
Term Deposits / CDs / Call Accounts	UK	Lloyds TSB (Lloyds Banking Group)	£3m*/ 15% of total investments at time of investing	£5m/ 15% of total investments at time of investing
Term Deposits / CDs / Call Accounts	UK	Barclays Bank Plc	£2m / 15% of total investments at time of investing	
Term Deposits / CDs / Call Accounts	UK	HSBC Bank Plc	£2m / 15% of total investments at time of investing	
Term Deposits / CDs / Call Accounts	UK	Nationwide Building Society	£2m / 15% of total investments at time of investing	
Term Deposits / CDs / Call Accounts	UK	NatWest ** (RBS Group)	£3m	£5m/ 15% of total investments at time of investing
Term Deposits / CDs / Call Accounts	UK	Royal Bank of Scotland (RBS Group)	£3m*/ 15% of total investments at time of investing	£5m/ 15% of total investments at time of investing

Instrument	Country/ Domicile	Counterparty	Maximum Counterparty Limit %/£m *	Maximum Group Limit (if applicable) %/£m
Term Deposits / CDs / Call Accounts	UK	Standard Chartered Bank	£2m / 15% of total investments at time of investing	
Term Deposits / CDs / Call Accounts	Australia	Australia and NZ Banking Group	£2m / 15% of total investments at time of investing	
Term Deposits / CDs / Call Accounts	Australia	Commonwealth Bank of Australia	£2m / 15% of total investments at time of investing	
Term Deposits / CDs / Call Accounts	Australia	National Australia Bank Ltd (National Australia Bank Group)	£2m / 15% of total investments at time of investing	
Term Deposits / CDs / Call Accounts	Australia	Westpac Banking Corp	£2m / 15% of total investments at time of investing	
Term Deposits / CDs / Call Accounts	Canada	Bank of Montreal	£2m / 15% of total investments at time of investing	
Term Deposits / CDs / Call Accounts	Canada	Bank of Nova Scotia	£2m / 15% of total investments at time of investing	
Term Deposits / CDs / Call Accounts	Canada	Canadian Imperial Bank of Commerce	£2m / 15% of total investments at time of investing	
Term Deposits / CDs / Call Accounts	Canada	Royal Bank of Canada	£2m / 15% of total investments at time of investing	
Term Deposits / CDs / Call Accounts	Canada	Toronto-Dominion Bank	£2m / 15% of total investments at time of investing	

Instrument	Country/ Domicile	Counterparty	Maximum Counterparty Limit %/£m *	Maximum Group Limit (if applicable) %/£m
Term Deposits / CDs / Call Accounts	US	JP Morgan	£2m / 15% of total investments at time of investing	

* £3m addition £1m limit applied to Banks with a significant UK Government shareholding
** Current Account, Additionally £1m with daily approval of the Head of Finance

Money Market Funds Domiciled Abroad

Addition information from the Council’s Treasury Management Consultants

The majority of Money Market Funds are domiciled in Ireland for the low corporation tax on offer. This should not be a concern as it does not increase a risk of default as none of the funds on our list have exposure to Ireland or any of its financial institutions. The credit risk lies with the underlying assets in a MMF and not the country where it is domiciled.

Although it is in a foreign country, there would be no legal action required. All unit holders would own a pro rata share of all the assets in the fund and if the fund were to *break the buck*[1], they would run down the maturities of them and then pay out the unit holders. This is a straight forward process in comparison to a bank being unwound as all the shareholders are ranked the same, the value of the instruments are easy to ascertain and the maximum duration of any investment is 397 days.

Arlingclose do not view there being any great benefit to a MMF being regulated in the UK. However there is a small risk that people in the country stop providing the vital services so the funds cannot function. But over the past couple of years Ireland has taken its pain upfront with 25% decrease in public sector pay and other stringent measures and in the past year there have been signs that they are beginning to come out of the other side with two strong quarters of growth in early 2011. All these factors would indicate that there would not be wide spread refusal to provide core services and these funds will continue to function.

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[1]*‘Break the buck’ means when a money market mutual fund's net asset value (NAV) drops below £1 per share. Money market funds assets have an implied promise to preserve capital at all costs and preserve the £1 floor on share prices, therefore if it drops below this level, it will be frozen and monies will be returned to investors in an orderly wind down of assets.*

TREASURY MANAGEMENT POLICY STATEMENT

1. INTRODUCTION AND BACKGROUND

1.1 The Council adopts the key recommendations of CIPFA's Treasury Management in the Public Services: Code of Practice (the Code), as described in Section 5 of the Code.

1.2 Accordingly, the Council will create and maintain, as the cornerstones for effective treasury management:-

- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities.
- Suitable treasury management practices (TMPs), setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

1.3 The Council (i.e. full Council) will receive reports on its treasury management policies, practices and activities including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.

1.4 The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to the Audit Committee and for the execution and administration of treasury management decisions to the Head of Finance, who will act in accordance with the organisation's policy statement and TMPs and CIPFA's Standard of Professional Practice on Treasury Management.

1.5 The Council nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

2. POLICIES AND OBJECTIVES OF TREASURY MANAGEMENT ACTIVITIES

2.1 The Council defines its treasury management activities as:

"The management of the Council'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."

2.2 This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

2.3 This Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

2.4 The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt.

2.5 The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Council's investments followed by the yield earned on investments remain important but are secondary considerations.

EXTRACT FROM CAB2287 Housing Revenue Account Budget 2012/13 and Business Plan 2012/13 to 2042/43, 1 February 2012

1 Proposals from the Housing Self Financing Informal Policy Group

1.1 Members of the Housing Self–Financing Informal Policy Group have considered options and examples for financing under Housing Reform by officers and external advisors at two meetings in January 2012.

1.2 Initial proposals were considered at the first meeting based on an early draft of the HRA Business Plan and a range of debt repayment options. A summary of the implications of the options are detailed in Table 1 below. The assumed HRA surpluses are small in the early years of the Plan but modelling suggests they increase significantly in the later years.

Table 1 – Business Plan/Treasury Management Options

Proposal	New Build Resources Years 1-10	Total 30 yr Interest Costs	HRA Surplus at Year 30
Initial Draft Business Plan - Pay debt when business plan allows (est. 3.8% borrowing costs)	£9.25 m (est.70 homes)	£110m	£124m
Take some short term debt and repay debt faster	£9.25m	£106m	£126m
Take all debt over 30 years (est. 3.8% borrowing costs)	£9.25m	£189m	£67m

1.3 Whilst recognising the plans were subject to change, members did feel that proposals relating to potential resources for new build were too cautious and asked that further modelling be undertaken to update the plan and to identify if debt could be structured in such a way as to increase the resources available for new build in the first 10 years of the Plan period.

1.4 The second meeting reviewed an updated business plan based on the budget proposals included later in this paper and also considered options presented by the Council's treasury management advisers, Arlingclose on how debt could be structured in such a way as to further increase resources available to the Plan in years 1 to 10 (see table 2). After discussion, all members of the Group supported these proposals and asked that the final business plan and HRA Budget proposals for 2012/13 be based on the option to raise £42m for new build in Years 1-10. Whilst total interest costs were increased over the 30 years, the proposal would allow significant additional investment in new homes, which, subject to final rent levels, would be self financing over a 30 year period.

Table 2 – Revised Business Plan/Treasury Management Options

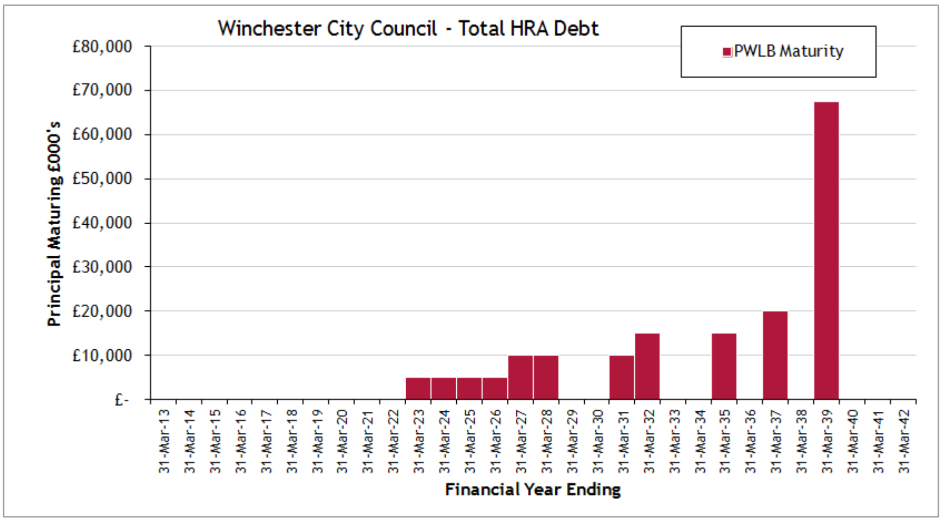
Proposal	New Build Resources Years 1-10	Total 30 yr Interest Costs	HRA Surplus at Year 30
Revised Business Plan, updated rent income and expenditure projections, increased provision for new build	£24m (est. 180 homes)	£106m	£198m
As above, but with debt structured to increase resources in years 1-10	£42m (est.300 homes)	£138m	£166m

1.5 The implications of structuring debt in accordance with the recommended option is indicated in tables 3 and 4 below:

Table 3 – Possible Debt Portfolio

New Loans				
Interest Calculation	Repayment Method	Principal	Period	Rate
Fixed	Maturity	- 5,000	11	2.91%
Fixed	Maturity	- 5,000	12	3.01%
Fixed	Maturity	- 5,000	13	3.10%
Fixed	Maturity	- 5,000	14	3.19%
Fixed	Maturity	- 10,000	15	3.29%
Fixed	Maturity	- 10,000	16	3.38%
Fixed	Maturity	- 10,000	19	3.66%
Fixed	Maturity	- 15,000	20	3.75%
Fixed	Maturity	- 15,000	23	3.79%
Fixed	Maturity	- 20,000	25	3.81%
Fixed	Maturity	- 67,407	27	3.83%
	TOTAL	- 167,407		

Table 4 – Possible Debt Portfolio



1.6 It should be noted that the interest rates included in table 3 are projections of likely rates on 26 March, and will almost certainly be subject to change. For example, a 1% increase in these interest rates, whilst considered very unlikely, would cost approximately £1.7m per annum, effectively removing £17m from the resources for new build in years 1 to 10. It would however still be possible to resource all other proposals in the business plan and budget.

Whilst this option has been used to formulate the proposed HRA Budget and Business Plan included in this paper, final borrowing decisions will be made in accordance with principles set out in the Council's Treasury Management Strategy, which need to be sufficiently flexible to allow decisions to take account of the interest rates on 26 March. The proposed Treasury Management Strategy will be considered at the February meetings of Cabinet and Council

HRA Debt - Risk Analysis Matrix (*source: Arlingclose Report on HRA Reform Debt Profiling*)

Risk	***Impact***	***Mitigation***
Exposure to interest rates on the settlement date	Funding cost could be entirely dictated by rates on 26th March, (if all PWLB debt), which may not be an opportune time to borrow	An element of fixed rate funding can be drawn in the window of opportunity prior to the CLG settlement.
Interest Rates Rise	Cost of funding contained in modelling is higher.	Consider borrowing in advance of the transaction – this action will be dependent on the timing of the enactment of the Localism Bill.
Interest Rates Fall	Opportunity costs are missed.	Structure the debt portfolio in as flexible a method as possible to allow restructuring of debt if opportunities present themselves.
Timing of borrowing	The Council may not be able to take advantage of any window of opportunity between enactment of the Localism Bill and the transaction date.	Ensure that the 2011/12 Treasury Management Strategy contains sufficient flexibility to borrow in the current financial year if required.
Settlement of transaction	Bank blocks settlement, resulting in late payment costs.	Bank limits required to allow transfer of large sums.
Legal, regulatory and compliance risks	LA acts outside its powers or approved strategy.	Ensure treasury strategy, annual investment strategy and Prudential Indicators are amended and approved as appropriate.
Counterparty risk	Counterparty default results in loss of capital / late payment to the Council.	Ensure appropriate strategy is adopted, particularly if borrowing & investing in advance of the settlement.