



PUBLIC SECTOR

# Annual Audit Letter 2009/10

Telford and Wrekin Council

November 2010

AUDIT

## The contacts at KPMG in connection with this report are:

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## Background

This Annual Audit Letter summarises the key issues arising from our 2009/10 audit of Telford and Wrekin Council ('the Authority'). Although this letter is addressed to the Members of the Authority, it is also intended to communicate these issues to key external stakeholders, including members of the public. The letter will also be published on the Audit Commission's website. It is the responsibility of the Authority to publish the letter on the Authority's website. In the letter we highlight areas of good performance and also provide recommendations to help you improve performance. A summary of our key recommendations is summarised in Appendix A. We have reported all the issues in this letter to you throughout the year and a list of all reports we have issued is provided in Appendix B.

## Scope of our audit

The statutory responsibilities and powers of appointed auditors are set out in the Audit Commission Act 1998. Our main responsibility is to carry out an audit that meets the requirements of the Audit Commission's Code of Audit Practice (the code) which requires us to report on:

### Use of Resources (UoR)

We conclude on the arrangements in place for securing economy, efficiency and effectiveness ('value for money') in your use of resources.

### Financial Statements

We provide an opinion on your accounts.

## Fees

Our fee to date for 2009/10 for the audit of the Authority is £255,000 excluding VAT (2008/09: £221,100). We received four questions/objections to the 2009/10 accounts from electors; our in relation to these questions is not yet finalised as our work is ongoing. Our fee to date for these queries is £17,330. Further details are provided in Appendix C.

This report is addressed to Telford and Wrekin Council and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission has issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document.

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Michael McDonagh who is the engagement lead to the Authority or Trevor Rees, the national contact partner for all of KPMG's work with the Audit Commission. After this, if you still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. You can contact the Complaints Unit by phone (0844 798 3131), by email (complaints@audit-commission.gov.uk), through the audit commission website (www.audit-commission.gov.uk/aboutus/contactus), by textphone/minicom (020 7630 0421), or via post to Complaints Unit, Audit Commission, Westward House, Lime Kiln Close, Stoke Gifford, Bristol, BS34 8SR.

# Headlines

## Use of Resources

### Use of Resources assessment

- In May 2010 the Government announced that the Comprehensive Area Assessment (CAA) would be abolished. The Audit Commission subsequently confirmed that work related to CAA should cease with immediate effect. This included work for UoR scored assessments at local authorities. However, there is no change to the requirement in the statutory Code of Audit Practice for auditors to issue a VFM conclusion.
- At the time of the announcement, the vast majority of UoR work for 2010 had already been completed and this therefore informed our 2009/10 VFM conclusion.
- The Authority has improved in most areas of the assessment and there were no significant issues arising from our work on specific risks.

### Our conclusion

- We issued an unqualified value for money conclusion for 2009/10. This means that we are satisfied that you have put into place proper arrangements for securing economy, efficiency and effectiveness in your use of resources.

## Financial Statements

### Annual accounts

- The Authority again produced a good quality set of accounts. We identified one material adjustment as part of our audit work with a total value of £12.5m; this related to accounting for fixed assets and did not impact on the General Fund.
- We received two objections to the accounts from registered electors. We are currently undertaking work in response to these objections and are unable to issue our Certificate confirming completion of our work in relation to the Authority's accounts until this work is complete. We will report the results of our work as appropriate.
- We also received two questions from electors. We are currently undertaking work in relation to these questions and will report the results of our work as appropriate.

### Annual Governance Statement

- We reviewed the Authority's Annual Governance Statement and concluded that it was consistent with our understanding of the Authority.

### Our conclusion

- We issued an unqualified opinion on your accounts on 30 September 2010. This means that we believe the accounts give a true and fair view of the financial affairs of the Council and of the income and expenditure recorded during the year.

# Headlines

<b>Recommendations</b>	<b>High risk recommendations</b>	<ul style="list-style-type: none"> <li>● We raised one high priority recommendation as a result of our 2009/10 audit work. The Authority is continuing to work towards implementation of Single Status having postponed its implementation date during the year. We recommended that key milestones in the implementation plan are appropriately monitored to ensure it achieves its new implementation date of June 2012. This recommendation is summarised in Appendix A.</li> </ul>
<b>High profile issues</b>	<b>Economic Downturn and pressure on the public sector</b>	<ul style="list-style-type: none"> <li>● Following the Government’s Spending Review announcement in October 2010, there is now greater clarity on the spending cuts that will affect local government. Local authorities will face 7.1% annual cuts in grant income representing 26% reductions over the next four years. Although this is less than many commentators had predicted, it still represents one of the biggest cuts for any part of the public sector. Detailed analysis will be required as further details of these funding cuts are clarified - the real impact will not be known until the government departments produce their business plans in November and organisations have a chance to digest the Chancellor’s messages.</li> <li>● The Authority has been preparing for cuts of this magnitude for some time, and its Medium Term Financial Strategy included sensitivity analysis for funding cuts of up to 7% prior to the Spending Review. Facing up to these challenges will require revolutionary transformation of public sector services, rather than tinkering. Strong leadership from Members and senior management will be essential.</li> </ul>
	<b>International Financial Reporting Standards (IFRS)</b>	<ul style="list-style-type: none"> <li>● From 2010/11, local government bodies are required to prepare their financial statements under International Financial Reporting Standards (IFRS), which contain a number of significant differences from the current financial reporting regime.</li> <li>● The Authority expects to have restated its opening balance sheet by the end of November 2010. We will provide advice to the Authority and review work undertaken as it becomes available.</li> </ul>

# Future audit work

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## Changes to next year's value for work programme

- Given the scale of the pressures facing public bodies in the current economic climate, the Audit Commission has reviewed its work programme for 2010/11 onwards. As part of this exercise, the Commission has been discussing possible options for a new approach to local value for money (VFM) audit work with key national stakeholders. From 2010/11 we will therefore apply a new, more targeted and better value approach to our local VFM audit work. This will be based on a reduced number of reporting criteria specified by the Commission, concentrating on:
  - securing financial resilience; and
  - prioritising resources within tighter budgets.
- We will determine a local programme of VFM audit work based on our audit risk assessment, informed by these criteria and our statutory responsibilities. We will no longer make annual scored judgements relating to our local VFM audit work. Instead we will report the results of all the local VFM audit work and the key messages for the audited body in our annual report to those charged with governance and in a clear and accessible annual audit letter.

## Future audit arrangements

- In August 2010 the Secretary of State for Communities and Local Government announced proposals to abolish the Audit Commission. The proposed abolition will be from 2012 and the government will seek legislation in this session of Parliament.
- There is no immediate change to the current audit arrangements. We will keep you informed about the future audit programme and any changes to audit arrangements.

## Appendix A: Key Recommendations

This appendix summarises all high risk recommendations raised in 2009/10.

We raised one high priority recommendation.

Risk	Issue, Impact and Recommendation	Management Response / Responsible Officer / Due Date
<p>● High</p>	<p>The Authority must ensure it implements Single Status by June 2012 with appropriate monitoring of milestones through the year to ensure this achieved.</p> <p>In addition, as implementation progresses, the Authority should ensure that it uses the most up to date information and relevant case law precedents, whilst taking into account any other changing circumstances so that it more accurately reflects the likely financial cost within its Medium Term Financial Strategy.</p>	<p>Meredith Evans, Corporate Director has lead responsibility for the implementation of Single Status.</p> <p>The Council will monitor any financial implications of the implementation of Single Status and adjust medium term financial plans accordingly.</p> <p>Quarterly update meetings on Single Status will be arranged between the Lead Officer, Head of Finance and KPMG.</p> <p>Responsible officer: Meredith Evans Due date: June 2012</p>

# Appendix B: Summary of Reports issued

This appendix summarises the reports we issued since our last Annual Audit Letter.

**Audit Plan (March 2010)**  
 The Audit Plan set out our approach to the audit of the Council's Use of Resources and Financial Statements .

**Report to those charged with governance (September 2010)**  
 The Report to Those Charged with Governance summarised the results of our audit for 2009/10 including key issues and recommendations raised as a result of our observations.  
 We also provided the mandatory declarations required under auditing standards as part of this report.



**Certification of Grants & Returns (February 2010)**  
 This report summarised the outcome form our certification work on the Council's 2008/09 grants and returns.

**Interim Audit Report (July 2010)**  
 The Interim Audit Report summarised the results from the preliminary stages of our audit, including testing of financial and other controls and our review of use of resources arrangements.

**Audit Report (September 2010)**  
 The Audit Report included our audit opinion for the year, the Value for Money conclusion and our Audit Certificate.

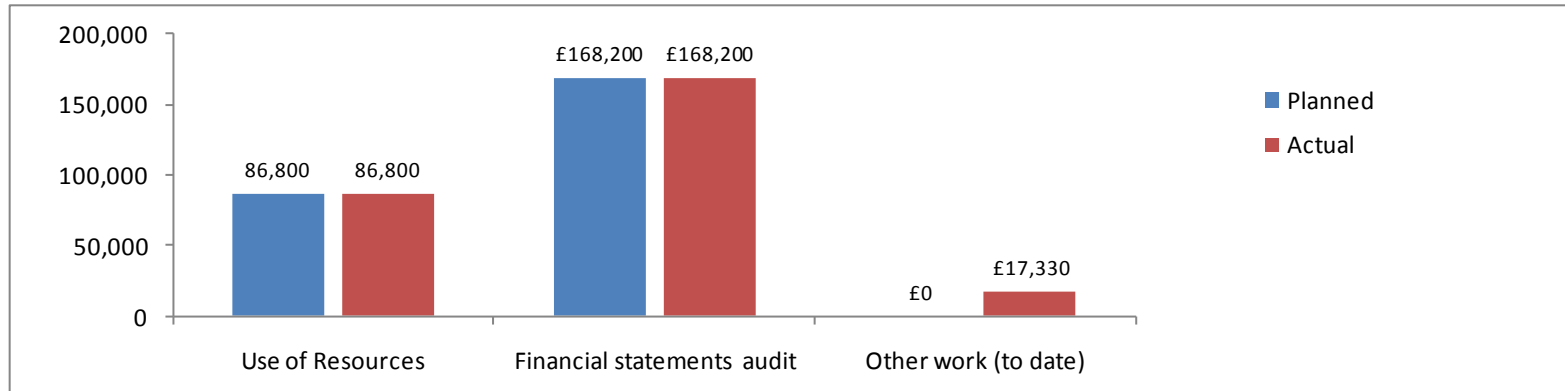
**Annual Audit Letter (November 2010)**  
 This Annual Audit Letter provides a summary of the results of our audit for 2009/10.

## Appendix C: Audit Fee

This appendix provides information on our final fees for 2009/10

To make sure that there is openness between us and your Audit Committee about the extent of our fee relationship with you, we have summarised below the out-turn against the 2009/10 planned external audit fee:

### External audit fee for 2009/10 (£)



Our final fee for the 2009/10 audit of the Council was £255,000 (2008/09:£221,100).

We have charged £17,330 to date for work in relation to four questions/objections received from local electors. Our work in relation to these is ongoing and the fee quoted is not final.

**TELFORD & WREKIN COUNCIL**

**AUDIT COMMITTEE – 1 FEBRUARY 2011  
CABINET – 22 FEBRUARY 2011  
COUNCIL – 3 MARCH 2011**

**2011/12 TREASURY STRATEGY AND TREASURY UPDATE REPORT  
REPORT OF THE CHIEF FINANCE OFFICER AND HEAD OF FINANCE**

**PART A – SUMMARY REPORT**

**1. SUMMARY OF MAIN PROPOSALS**

The report details the Treasury Strategy to be adopted for 2011/12.

The Committee may, within their terms of reference, make recommendations to Cabinet.

**2. RECOMMENDATIONS**

Members are asked to note the treasury management activities for the first half year and recommend the Treasury Strategy to Cabinet for approval.

**3. SUMMARY IMPACT ASSESSMENT**

**COMMUNITY IMPACT** Do these proposals contribute to specific priority plan objectives?

Yes/~~No~~ Efficient Community Focussed Council

Will the proposals impact on specific groups of people?

~~Yes~~/No

**TARGET  
COMPLETION /  
DELIVERY DATE**

Part of ongoing Treasury Management Activities within the Treasury Management Strategy and Policy approved by Council.

**FINANCIAL/VALUE  
FOR MONEY IMPACT**

Yes/~~No~~ Where appropriate these are detailed in the body of the report.

**LEGAL ISSUES**

Yes/~~No~~ The Head of Finance and (Section 151 Officer) has responsibility for the administration of the financial affairs of the Council. In providing this report the Head of Finance is meeting one of the responsibilities of the post contained within the Council's Constitution at Part 2, Article

12, paragraph 12.04(f) which states “The Chief financial Officer will contribute to the promotion and maintenance of high standards of governance, audit, probity and propriety, risk management and the approval of the statement of accounts through provision of support to the Audit Committee.”

**OTHER IMPACTS, RISKS AND OPPORTUNITIES**

Yes/No

The key opportunities and risks associated with treasury management activities are set out in the body of the report and in the Treasury Management Strategy and Policy approved by Council and will be regularly monitored throughout the year.

**IMPACT ON SPECIFIC WARDS**

Yes/No

**PART B – ADDITIONAL INFORMATION**

**4. 2010/11 TREASURY MANAGEMENT UPDATE**

**4.1 CURRENT PORTFOLIO POSITION**

	<i>31 March 2010</i>	<i>31 Dec 2010</i>
	<b>Principal</b>	<b>Principal</b>
	<b>£m</b>	<b>£m</b>
Fixed Rate Borrowing	118.024	118.024
Variable Rate Borrowing	<u>5.000</u>	<u>9.500</u>
<b>Total Debt</b>	<b>123.024</b>	<b>127.524</b>
Investments - in-house	54.033	82.340
- with external managers	<u>19.811</u>	<u>0.000</u>
<b>Total Investments</b>	<b>73.844</b>	<b>82.340</b>
<b>Net Indebtedness</b>	<b>49.180</b>	<b>45.184</b>

**4.2 INTEREST RATES**

Base rates began the year at 0.5% and have remained there all year. The Bank of England extended its Quantative Easing programme during last year to £200bn. There has not been any extension to this nor any unwinding during the current year. The next move in the base rate is expected to be upwards, but not until late 2011 and will be strongly linked to how the economy recovers.

### **4.3 BORROWING & RESCHEDULING**

The borrowing strategy for the current year has been to use maturing investments to reduce borrowing.

#### **Rescheduling**

During 2010/11 no rescheduling has taken place as market conditions have not been favourable, however the scope for opportunities is regularly monitored.

#### **New Borrowing**

During May and November two of our short term PWLB loans both for £5m matured. 2 new PWLB loans were taken in August both for £5m and 10 years with Equal Instalments of Principal. These are to fund capital investment. The borrowing has been undertaken in advance to take advantage of current favourable rates. Rates are predicted to increase over the next few months.

As part of the Comprehensive Spending Review in October, the Government announced an increase to the interest rates on loans from the PWLB, which saw PWLB borrowing costs rise by around 0.9%.

Between the period 1 June 2010 (previous Member update) and 31 December 2010, £34.2m of temporary loans have been raised in order to fund short-term cash flow requirements at various points. Interest rates have ranged from 0.28% to 0.60% - interest rates have remained fairly low during this time. £4.5m of this temporary borrowing was outstanding at 31 December 2010.

### **4.4 INVESTMENTS**

The strategy for the current year is: To gain maximum benefit, subject to risk control parameters, whilst achieving as a minimum target the 7 day deposit rate.

#### **4.4.1 Fund Managers**

It has been very difficult for Fund Managers to achieve reasonable rates of return in the current climate and the outlook for future years is only slightly more promising. The Council had one fund manager between April and December 2010 who achieved a return of 0.98%. All funds have now been withdrawn given the very low rate of return being achieved and limited prospects for improvement in the short and medium term.

#### **4.4.2 In-House Investments**

The majority of the Council's investments are internally managed - a mix of both temporary investments for cash flow purposes and longer term investments are undertaken internally. The target return is to achieve at least

the 7 day deposit rate.

#### Temporary Investments

A proportion of funds are invested by the Council's own officers in order to maximise returns from day to day cash flows

In total £692.5m of investments were placed between 1 June and 31 December. Interest rates have ranged from 0.25% to 0.80% and periods ranged from overnight deposits to 40 days. £17.3m in house temporary investments were held at 31 December 2010.

#### Longer Term Investments

A number of internally managed deposits have been made previously as an alternative to fund managers. This has been added to during 2010/11 with a £10m one year investment at 2.15%, a £5m one year investment at 1.9% and a £5m six month investment at 1.33%. A full list of longer term investments is shown below.

		£m	%
Fixed Deposit	22/01/07 – 24/01/11	5.0	5.52
Fixed Deposit	01/10/08 – 01/10/13	5.0	6.62
Fixed Deposit	02/10/08 – 02/10/13	5.0	6.80
Variable Deposit	30/07/08 – 30/07/12	10.0	1.00
Fixed Deposit	03/08/09 – 01/08/14	5.0	6.32
Fixed Deposit	06/03/09 – 06/03/14	5.0	6.31
Fixed Deposit	31/03/09 – 31/03/14	5.0	6.37
Fixed Deposit	22/04/09 – 22/04/14	5.0	6.35
Fixed Deposit	09/07/10 – 15/07/11	10.0	2.15
Fixed Deposit	18/11/10 – 17/11/11	5.0	1.90
Fixed Deposit	18/11/10 – 17/05/11	5.0	1.33
Total		65.0	

It should be noted that under the current guidance from our Treasury Advisors our investment policy would mean that investments should not be placed for longer than 2 years. However the majority of these investments were placed before the start of the financial crisis which resulted in recommended periods for maximum duration being shortened. The council is benefiting from very attractive rates of interest that are no longer available.

Overall the weighted average return on all internal investments for the year to date was 3.74% compared to a benchmark return for the period of 0.40% representing a projected annual additional £2.1m generated over what we would have achieved had all the investments been short term.

#### **4.4.3 Overall Position and Exposure**

A full analysis of all Council investments at the end of December is shown in

Appendix E.

Our current maximum exposure is £20.0m with any one counterparty which was agreed when we had 3 fund managers, Counterparty limits will be reviewed when our long term investments mature in 2014. At the end of December the greatest exposure with a single counterparty was £20.0m with Barclays and £20m with Royal Bank of Scotland (24.3% of the total portfolio).

No investments in Supranational Bonds were held at the end of December.

The Council is guided by its Treasury advisers, Arlingclose, in assessing investments.

#### **4.5 LEASING**

Each year the Council arranges operating and finance leases for assets such as vehicles, computers and equipment. This helps to spread the cost over a number of years.

The first drawdown for 2010/11 took place in October for ICT equipment and vehicles. The value of the lease is £120,305 with JCB Finance.

<b>5.</b>	<b><u>PREVIOUS MINUTES</u></b>
	Audit Committee 2 February 2010 Audit Committee 10 February 2010 Council 4 March 2010 Audit Committee 28 June 2010 Audit Committee 2 November 2010

#### **6. TREASURY STRATEGY FOR 2011/12 to 2013/14**

##### **6.1 BACKGROUND**

##### **6.1.1 The CIPFA Treasury Management Code of Practice 2009**

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 on an annual basis. The TMSS also incorporates the Investment Strategy as required under the CLG's Investment Guidance.

CIPFA has defined Treasury Management as:

*"the management of the organisation'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."*

The Council is responsible for its treasury decisions and activity. No treasury management activity is without risk. The successful identification, monitoring and control of risk are integral element to treasury management activities and include Credit and Counterparty Risk, Liquidity Risk, Market or Interest Rate Risk, Refinancing Risk and Legal and Regulatory Risk.

The strategy takes into account the impact of the Council's Revenue Budget and Capital Programme on the Balance Sheet position, the current and projected Treasury position (Appendix A), the Prudential Indicators and the outlook for interest rates (Appendix B).

The purpose of this TMSS is to approve:

- Treasury Management Strategy for 2011-12 (Borrowing and Debt Rescheduling - Section 6.2, Investments - Section 6.3)
- Prudential Indicators – (NB: the Authorised Limit is a statutory limit)
- MRP Statement – Section 6.6
- Use of Specified and Non-Specified Investments – Appendices C & D.

The Council approved the adoption of the CIPFA Treasury Management Code at its meeting on 4 March 2010, which incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices.

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

### 6.1.2 Balance Sheet and Treasury Position

The underlying need to borrow for capital purposes, as measured by the Capital Financing Requirement (CFR), together with Balances and Reserves, are the core drivers of Treasury Management Activity. The estimates, based on the current Revenue Budget and Capital Programmes, are:

	31/03/2011 Estimate £m	31/03/2012 Estimate £m	31/03/2013 Estimate £m	31/03/2014 Estimate £m	31/03/2015 Estimate £m
Capital Financing Requirement	242.775	282.021	266.867	261.632	232.477

6.1.3 The Council's level of physical debt and investments is linked to the CFR and level of Balances and Reserves. The current portfolio position is set out at Appendix A. Market conditions, interest rate expectations and credit risk considerations will influence the Council's strategy in determining the borrowing and investment activity against the underlying Balance Sheet position. The Council will ensure that net physical external borrowing (i.e. net of investments) will not exceed the CFR other than for short term cash flow

requirements.

#### 6.1.4 Estimates of Capital Expenditure

2.3. It is a requirement of the Prudential Code to ensure that capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax.

Capital Expenditure	2010/11 Approved £m	2010/11 Revised £m	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m	2014/15 Estimate £m
<b>Total</b>	<b>95.510</b>	<b>104.360</b>	<b>112.481</b>	<b>94.314</b>	<b>69.009</b>	<b>71.886</b>

Capital expenditure is expected to be financed as follows

Capital Financing	2010/11 Approved £m	2010/11 Revised £m	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m	2014/15 Estimate £m
Capital receipts	2.067	2.494	8.086	32.935	12.600	24.177
Government Grants	45.986	55.659	58.236	69.300	54.057	69.020
Revenue / External contributions	0.000	3.034	0.194	0.000	0.000	0.000
<b>Total Financing</b>	<b>48.053</b>	<b>61.187</b>	<b>66.516</b>	<b>102.235</b>	<b>66.657</b>	<b>93.197</b>
Supported borrowing	5.728	7.211	0.387	0.000	0.000	0.000
Unsupported borrowing	41.729	35.962	45.578	-7.921	2.352	-21.311
<b>Total Funding</b>	<b>47.457</b>	<b>43.173</b>	<b>45.965</b>	<b>-7.921</b>	<b>2.352</b>	<b>-21.311</b>
<b>Total Financing and Funding</b>	<b>95.510</b>	<b>104.360</b>	<b>112.481</b>	<b>94.314</b>	<b>69.009</b>	<b>71.886</b>

#### Incremental Impact of Capital Investment Decisions:

##### 6.1.5 Incremental Impact of Capital Investment Decisions:

As an indicator of affordability the table below 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.

Incremental Impact of Capital Investment Decisions	2010/11 Approved £	2011/12 Estimate £	2012/13 Estimate £	2013/14 Estimate £	2014/15 Estimate £m
Revenue Impact – in year		46,000	83,000	-15,000	-8,000
Revenue Impact - cumulative		46,000	129,000	114,000	106,000
Increase in Band B Council Tax	6.47	0.70	1.97	1.74	1.62

**6.1.6** The estimate for interest payments in 2011/12 is £6.523m and for interest receipts is £2.783m. The ratio of financing costs to the Council's net revenue stream 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 borrowing costs. The ratio is based on costs net of investment income.

<b>Ratio of Financing Costs to Net Revenue Stream</b>	<b>2010/11 Approved %</b>	<b>2010/11 Revised %</b>	<b>2011/12 Estimate %</b>	<b>2012/13 Estimate %</b>	<b>2013/14 Estimate %</b>	<b>2014/15 Estimate %</b>
Non-HRA	2.95	2.40	2.70	3.85	3.85	4.45

## **6.2 Borrowing and Rescheduling Strategy**

**6.2.1** The Council's balance of actual gross borrowing plus other long-term liabilities is shown in Appendix A. This is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

**6.2.2** The Authorised Limit sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) and is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

<b>Authorised Limit for External Debt</b>	<b>2010/11 Approved £m</b>	<b>2010/11 Revised £m</b>	<b>2011/12 Estimate £m</b>	<b>2012/13 Estimate £m</b>	<b>2013/14 Estimate £m</b>	<b>2014/15 Estimate £m</b>
Borrowing	300	300	330	320	320	300
Other Long-term Liabilities	6	6	6	6	6	6
<b>Total</b>	<b>306</b>	<b>306</b>	<b>336</b>	<b>326</b>	<b>326</b>	<b>306</b>

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

<b>Operational Boundary for External Debt</b>	<b>2010/11 Approved £m</b>	<b>2010/11 Revised £m</b>	<b>2011/12 Estimate £m</b>	<b>2012/13 Estimate £m</b>	<b>2013/14 Estimate £m</b>	<b>2014/15 Estimate £m</b>
Borrowing	280	280	310	300	300	280
Other Long-term Liabilities	4	4	4	4	4	4
<b>Total</b>	<b>284</b>	<b>284</b>	<b>314</b>	<b>304</b>	<b>314</b>	<b>284</b>

**6.2.4** The Chief Finance Officer 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 Council.

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

- PWLB loans
- Borrowing from other local authorities
- Borrowing from institutions such as the European Investment Bank and directly from Commercial Banks
- Borrowing from the Money Markets
- Medium Term Notes
- Local authority stock issues
- Structured finance

**6.2.6** Notwithstanding the issuance of Circular 147 on 20th October following the CSR announcement which increases the cost of new local authority fixed rate loans to 1% above the cost of the Government's borrowing, the PWLB remains an attractive source of borrowing, given the transparency and control that its facilities continue to provide. The types of PWLB borrowing that are considered appropriate for a low interest rate environment are:

- Variable rate borrowing
- Medium-term year Equal Instalments of Principal (EIP) or Annuity Loans
- Long-term Maturity loans, where affordable

Capital expenditure levels, market conditions and interest rate levels will be monitored during the year in order to minimise borrowing costs over the medium to longer term and maintaining stability. The differential between debt costs and investment earnings, despite long term borrowing rates being at low levels, remains acute and this is expected to remain a feature during 2011/12. The "cost of carry" associated with medium-term and long-term borrowing compared to temporary investment returns means that new fixed rate borrowing could entail additional short-term costs. The use of internal resources in lieu of borrowing may again, in 2011/12, be the most cost effective means of financing capital expenditure.

**6.2.7** PWLB variable rates are expected to remain low as the Bank Rate is maintained at historically low levels for an extended period. Exposure to variable interest rates will be kept under regular review. Each time the spread between long-term rates and variable rates narrows by 0.50%, this will trigger a formal review point and options will be considered in conjunction with the Authority's Treasury Advisor and decisions taken on whether to retain the same exposure or change from variable to fixed rate debt.

**6.2.8** The Council has £60.0m loans which are LOBO loans (Lender's Options Borrower's Option) of which £35.0m of loans are currently in or will be in their call period in 2011/12. In the event that the lender exercises the option to change the rate or terms of the loan, the Council will consider the terms being provided and also repayment of the loan without penalty. The Council may

utilise cash resources for repayment or may consider replacing the loan(s) by borrowing from the PWLB. The default response will however be early repayment without penalty.

**6.2.9** The Council is able to under certain circumstances to borrow in advance of spending needs as our borrowing is currently well below our CFR we don't anticipate an borrowing in advance during 2011/12, especially given the cost of carry associated with any such borrowing.

**6.2.10** The rationale for rescheduling would be one or more of the following:

- Savings in interest costs with minimal risk
- Balancing the volatility profile (i.e. the ratio of fixed to variable rate debt) of the debt portfolio
- Amending the profile of maturing debt to reduce any inherent refinancing risks.

As opportunities arise, they will be identified by Arlingclose and discussed with the Council's officers.

**6.2.11** Borrowing and rescheduling activity will be reported to the Audit Committee.

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

The Council's existing level of fixed interest rate exposure is 96% and variable rate exposure is 4%.

	2010/11 Approved %	2010/11 Revised %	2011/12 Estimate %	2012/13 Estimate %	2013/14 Estimate %
<b>Upper Limit for Fixed Interest Rate Exposure</b>	100	100	100	100	100
<b>Upper Limit for Variable Interest Rate Exposure</b>	25	25	30	30	30
<b>Local Indicator – Upper limit for net variable rate exposure. (Net principal re gross variable rate borrowing and investments divided by gross borrowing plus investments)</b>	80	80	60	60	60

**6.2.13** The Council will also limit and monitor large concentrations of fixed rate debt needing to be replaced. Limits in the following table are intended to control excessive exposures to volatility in interest rates when refinancing maturing debt.

<b>Maturity structure of fixed rate borrowing</b>	<b>Existing level at 31/03/10 %</b>	<b>Lower Limit for 2011/12 %</b>	<b>Upper Limit for 2011/12 %</b>
under 12 months	8.5	0	20
12 months and within 24 months	12.7	0	25
24 months and within 5 years	12.7	0	50
5 years and within 10 years	0.0	0	75
10 years and within 20 years	0.0	0	75
20 years and within 30 years	0.0	0	75
30 years and within 40 years	0.0	0	100
40 years and within 50 years	23.7	10	100
50 years and above	42.4	15	100

### **6.3 Investment Policy and Strategy**

**6.3.1** Guidance from CLG on Local Government Investments in England requires that an Annual Investment Strategy (AIS) be set.

**6.3.2** The Council's investment priorities are:

- security of the invested capital;
- liquidity of the invested capital;
- an optimum yield which is commensurate with security and liquidity.

**6.3.3** Investments are categorised as 'Specified' or 'Non Specified' investments based on the criteria in the CLG Guidance. Potential instruments for the Council's use within its investment strategy are contained in Appendices C and D. The Chief Finance Officer, under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on the core investment portfolio will be reported to the Audit Committee.

**6.3.4** Changes to investment strategy for 2011/12 include:

- AAA-rate Variable Net Asset Value (VNAV) Money Market Funds
- T-Bills
- Term deposits in Sweden
- Maximum duration for new deposits 2 years

**6.3.5** As identified in Section 6.2.9 of this TMSS, the Council's investments include £0m borrowed in advance of spending needs .

The management of risks, including the risk of loss of the borrowed capital are identical to all forms of investment as set out in this strategy. The risk associated with interest rate changes are based on the Interest Rate forecast at Appendix C and the current "cost of carry".

- 6.3.6** The Council's current level of investments is presented at Appendix A and E.
- 6.3.7** The Council's in-house investments are made with reference to the outlook for the UK Bank Rate and money market rates.
- 6.3.8** In any period of significant stress in the markets, the default position is for investments to be made with the Debt Management Office or UK Treasury Bills. (The rates of interest from the DMADF are below equivalent money market rates, but the returns are an acceptable trade-off for the guarantee that the Council's capital is secure.)
- 6.3.9** The Council selects countries and the institutions within them (see Appendix C), for the counterparty list after analysis and careful monitoring of:
- Credit Ratings (minimum long-term A+ for counterparties; AA+ for countries)
  - Credit Default Swaps (where quoted)
  - GDP; Net Debt as a Percentage of GDP
  - Sovereign Support Mechanisms/potential support from a well-resourced parent institution
  - Share Prices
  - Macro-economic indicators
  - Corporate developments, news and articles , market sentiment.
  - Maximum placed with a non UK sovereign – 20%

A guide to credit ratings is included in Appendix F

Counterparty limits will have to be reviewed should the Council decide to employ Fund Managers to manage investments in the future.

- 6.3.10** The Council and its Treasury Advisors, Arlingclose, will continue to analyse and monitor these indicators and credit developments on a regular basis and respond as necessary to ensure security of the capital sums invested.
- 6.3.11** The UK Bank Rate has been maintained at 0.5% since March 2009, and is anticipated to remain at low levels throughout 2011/12. Short-term money market rates are likely to remain at very low levels for an extended period which will have a significant impact on investment income.
- 6.3.12** To protect against a lower for longer prolonged period of low interest rates and to provide certainty of income, 2 year deposits and longer-term secure investments will be actively considered within the limits the Council has set for Non-Specified Investments (see Appendix D). The longer-term investments will be likely to include:
- Term Deposits with counterparties rated at least A+ (or equivalent)
  - Supranational Bonds (bonds issued by multilateral development banks):
- Even at the lower yields likely to be in force, the return on these bonds will provide certainty of income against an outlook of low official interest rates.
- 6.3.13** The Council has placed an upper limit for principal sums invested for over 364 days, as required by the Prudential Code. 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. The relatively high limit is as a result of a number of long term investments being placed before the start of the financial crisis and more recently the reduction in investments mainly through withdrawal of funds from fund managers rather than incur borrowing.

No 12	Upper Limit for total principal sums invested over 364 days	2010/11 Approved %	2010/11 Revised %	2011/12 Estimate %	2012/13 Estimate %	2013/14 Estimate %	2014/15 Estimate %
		90	90	95	95	95	95

**6.3.14** Liquidity Risk - As the Council has ready access to borrowings from the Public Works Loans Board, there is no significant risk that it will be unable to raise finance to meet its commitments in relation to financial instruments. The Council's strategy is also to ensure that not more than 40% of fixed rate loans are due to mature within the next three-year period through a combination of careful planning of new loans taken out and (where it is economic to do so) making early repayments. The Council also maintains some investments in liquidity/call accounts to provide immediate access to funds, if required.

**6.3.15** Market Risk - During periods of falling interest rates, and where economic circumstances make it favourable, fixed rate loans will be repaid early to limit exposure to losses. The risk of loss is ameliorated by the fact that a proportion of government grant payable on financing costs will normally move with prevailing interest rates or the authority's cost of borrowing and provide compensation for a proportion of any higher costs.

The treasury management team has an active strategy for assessing interest rate exposure that feeds into the setting of the annual budget and which is used to update the budget monitoring during the year. This allows any adverse changes to be accommodated. The analysis will also advise whether new borrowing taken out is fixed or variable.

Going into 2011/12, the Council does not have investments managed by an external fund manager which are subject to price revaluations and therefore to market risk. This risk would arise should monies be reinvested through external fund management at any point in the year.

## **6.4 Outlook for Interest Rates**

**6.4.1** The economic interest rate outlook provided by the Council's treasury advisor, Arlingclose Ltd, is attached at Appendix B. The Council will reappraise its strategy from time to time and, if needs be, realign it with evolving market conditions and expectations for future interest rates.

## **6.5 Balanced Budget Requirement**

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

## **6.6 2011/12 MRP Statement**

**6.6.1** 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 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.

**6.6.2** The four MRP options available are:  
Option 1: Regulatory Method  
Option 2: CFR Method  
Option 3: Asset Life Method  
Option 4: Depreciation Method  
NB This does not preclude other prudent methods.

**6.6.3** MRP in 2011/12: Options 1 and 2 may be used only for supported expenditure. Methods of making prudent provision for self financed expenditure include Options 3 and 4 (which may also be used for supported expenditure if the Council chooses).

**6.6.4** The MRP Statement will be submitted to Council before the start of the 2011/12 financial year. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement should be put to Council at that time.

**6.6.5** The Council will apply Option 1 in respect of supported capital expenditure and Option 3 in respect of unsupported capital expenditure.

And

MRP in respect of leases brought on Balance Sheet under the IFRS-based Code of Practice will match the annual principal repayment for the associated deferred liability.

## **6.7 Monitoring and Reporting on the Treasury Outturn and Prudential Indicators**

**6.7.1** Treasury activity is monitored monthly and reported internally to the Audit Committee on a quarterly basis. The Prudential Indicators will be monitored through the year and reported as under :

The Head of Finance will report to the Audit Committee on treasury management activity / performance and Performance Indicators as follows:

(a) quarterly against the strategy approved for the year.

(b) The Council will produce an outturn report on its treasury activity no later than 30th June after the financial year end.

(c) Audit Committee will be responsible for the scrutiny of treasury management activity and practices.

## **6.8 Other Issues**

### **6.8.1 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: The Head of Finance will ensure that those responsible for undertaking treasury activities are appropriately trained and kept up to date. Our treasury advisers provide regular free courses to assist with this..

### **6.8.2 Investment Consultants**

The Council uses Arlingclose as its external treasury management advisers.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

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

## **7. BACKGROUND PAPERS**

CIPFA Code of Practice for Treasury Management in Local Authorities  
Fund Manager Valuations  
Temporary Borrowing Records  
PWLB records  
Investment records  
Draft Treasury Strategy provided by Arlingclose  
Local Government Act 2003  
CLG Guidance on Local Authority Investments  
Audit Commission – Risk and Return

Report prepared by  
Bernie Morris, Finance Manager (01952) 383702  
Ken Clarke, Head of Finance (01952) 383100.

APPENDIX A

EXISTING PORTFOLIO PROJECTED FORWARD

	Current Portfolio £m	%	31/3/11 Estimate £m	31/3/12 Estimate £m	31/3/13 Estimate £m	31/3/14 Estimate £m	31/3/15 Estimate £m
<b>External Borrowing:</b>							
Fixed Rate – PWLB	63.0	33	106.2	125.3	125.3	125.3	125.3
Fixed Rate – Market	55.0	29	55.0	60.0	60.0	60.0	60.0
Variable Rate – PWLB	0.0	0	0.0	0.0	0.0	0.0	0.0
Variable Rate – Market	9.5	5	5.0	26.9	19.0	21.3	0.0
<b>Total External Borrowing</b>	<b>127.5</b>	<b>67</b>	<b>166.2</b>	<b>212.2</b>	<b>204.3</b>	<b>206.6</b>	<b>185.3</b>
<b>IFRS Long Term Liabilities:</b>							
PFI	63.4	33	63.4	62.4	61.0	59.7	58.0
Finance Leases	0.7	0	0.7	0.7	0.7	0.7	0.7
<b>Total Gross External Debt</b>	<b>191.6</b>	<b>100</b>	<b>230.3</b>	<b>275.3</b>	<b>266.0</b>	<b>267.0</b>	<b>244.0</b>
<b>Investments:</b> <i>Managed in-house</i>							
Short-term monies (Deposits/ monies on call /MMFs)	42.3	51	35.0	45.0	55.0	55.0	55.0
Long-term investments (maturities over 12 months)	40.0	49	40.0	30.0	20.0	20.0	20.0
<b>Total Investments</b>	<b>82.3</b>	<b>100</b>	<b>75.0</b>	<b>75.0</b>	<b>75.0</b>	<b>75.0</b>	<b>75.0</b>
<b>(Net Borrowing Position)/ Net Investment position</b>	<b>(109.3)</b>		<b>(155.3)</b>	<b>(200.3)</b>	<b>(191.0)</b>	<b>(192.0)</b>	<b>(169.3)</b>

### Arlingclose's Economic and Interest Rate Forecast

	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13
<b>Official Bank Rate</b>											
<b>Upside risk</b>	-	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50
<b>Central case</b>	0.50	0.50	0.50	0.75	1.00	1.25	1.50	2.00	2.50	2.75	2.75
<b>Downside risk</b>	-	-	-	- 0.25	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50
<b>1-yr LIBID</b>											
<b>Upside risk</b>	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
<b>Central case</b>	1.50	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.50	3.50	3.50
<b>Downside risk</b>	- 0.25	- 0.25	- 0.25	- 0.25	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50
<b>5-yr gilt</b>											
<b>Upside risk</b>	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
<b>Central case</b>	2.00	2.25	2.75	3.25	3.50	3.75	4.00	4.00	4.00	4.00	4.00
<b>Downside risk</b>	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25
<b>10-yr gilt</b>											
<b>Upside risk</b>	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50
<b>Central case</b>	3.50	3.75	3.75	4.00	4.25	4.50	4.75	4.75	4.75	4.75	4.75
<b>Downside risk</b>	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25
<b>20-yr gilt</b>											
<b>Upside risk</b>	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50
<b>Central case</b>	4.25	4.50	4.75	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00
<b>Downside risk</b>	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25
<b>50-yr gilt</b>											
<b>Upside risk</b>	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
<b>Central case</b>	4.25	4.25	4.50	4.75	4.75	4.75	4.75	4.50	4.50	4.50	4.50
<b>Downside risk</b>	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25	- 0.25

- The recovery in growth is likely to be slow, uneven and more “Square root” than “V” shaped.
- The initial reaction to the CSR is positive but implementation risks remain.
- The path of base rates reflects the fragility of the recovery and the significantly greater fiscal tightening of the emergency budget. With growth and underlying inflation likely to remain subdued, the Bank will stick to its lower for longer stance on policy rates.
- Gilts will remain volatile as the growth versus headline inflation debate escalates

#### Underlying assumptions:

- The framework and target announced in the Comprehensive Spending Review to reduce the budget deficit and government debt are the same as announced in June and focuses on how the cuts are to be distributed. The next big fiscal milestone will be the Office Of Budget Responsibility's assessment of the CSR's implications for growth, employment and inflation.
- The minutes of the Monetary Policy Committee's meeting suggest an increased likelihood of further Quantitative Easing. Money supply is weak and growth prospects remain subdued. The analysis and projections in November's Quarterly Inflation Report will give the Bank of England the opportunity to re-evaluate the outlook for economic activity and inflation and the fiscal impact of the CSR.
- Consumer Price Inflation is stubbornly above 3% and could remain higher than the MPC has previously forecast.

- The employment outlook remains uncertain, as unemployment remains near a 16 year high at just over 2.4 Million.
- The recently announced Basel III capital/liquidity rules and extended timescales is positive for banks. However, the restructuring of UK bank balance sheets is ongoing and expected to take a long time to complete, and is a pre-condition for eventual normalisation of credit conditions and bank lending.
- A high savings ratio combined with a reduction in net consumer credit and weak consumer confidence are consistent with lower consumption and therefore future trend rate of growth despite Q2's strong performance.
- Uncertainty surrounding Eurozone sovereign debt and the risk of contagion will remain a driver of global credit market sentiment.
- The US Federal Reserve downgraded its outlook for US growth; the Fed is concerned enough to signal further QE through asset purchases might be required. Industrial production and growth in the Chinese economy are showing signs of slowing. Both have implications for the global economy.

## Specified and Non Specified Investments

### **Specified Investments identified for use by the Council**

Specified Investments will be those that meet the criteria in the CLG Guidance, i.e. the investment

- is sterling denominated
- has a maximum maturity of 1 year
- meets the “high credit quality” as determined by the Council or is made with the UK government or is made with a local authority in England, Wales, Scotland or Northern Ireland or a parish or community council.
- the making of which is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate).

“Specified” Investments identified for the Council’s use are:

- Deposits in the DMO’s Debt Management Account Deposit Facility
  - Deposits with UK local authorities
  - Deposits with banks and building societies
  - \*Certificates of deposit with banks and building societies
  - \*Gilts: (bonds issued by the UK government)
  - \*Bonds issued by multilateral development banks
  - Treasury-Bills (T-Bills)
  - AAA-rated Money Market Funds with a Constant Net Asset Value (CNAV)
  - AAA-rated Money Market Funds with a Variable Net Asset Value (VNAV)
  - Other Money Market Funds and Collective Investment Schemes– i.e. credit rated funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.
1. *\* Investments in these instruments will be on advice from the Council’s treasury advisor.*
  2. *The use of the above instruments by the Council’s fund manager(s) will be by reference to the fund guidelines contained in the agreement between the Council and the individual manager.*

For credit rated counterparties, the minimum criteria will be the lowest equivalent short-term and long-term ratings assigned by Fitch, Moody’s and Standard & Poor’s (where assigned).

*Long-term minimum: A+(Fitch); A1 (Moody’s); A+ (S&P)*

*Short-term minimum: F1 (Fitch); P-1 (Moody’s); A-1 (S&P)*

The Council will also take into account information on corporate developments of and market sentiment towards investment counterparties.

New specified investments will be made within the following limits:

<b>Instrument</b>	<b>Country/ Domicile</b>	<b>Counterparty</b>	<b>Maximum Counterp arty Limits £m</b>
Term Deposits	UK	DMADF, DMO	No limit
Term Deposits/Call Accounts	UK	Other UK Local Authorities	No limit
Term Deposits/Call Accounts	UK*	Counterparties rated at least A+ Long Term and F1 Short Term (or equivalent)	£20m
Term Deposits/Call Accounts	Non-UK*	Counterparties rated at least A+ Long Term and F1 Short Term (or equivalent) in select countries with a Sovereign Rating of at least AA+	£20m
Gilts	UK	DMO	No limit
T-Bills	UK	DMO	No limit
Bonds issued by multilateral development banks		(For example, European Investment Bank/Council of Europe, Inter American Development Bank)	£30m
AAA-rated Money Market Funds	UK/Ireland / Luxembou rg domiciled	CNAV MMFs VNAV MMFs (where there is greater than 12 month history of a consistent £1 Net Asset Value)	£20m
Other MMFs and CIS	UK/Ireland / Luxembou rg domiciled	Pooled funds which meet the definition of a Collective Investment Scheme per SI 2004 No 534 and subsequent amendments	£20m

*NB Any existing deposits outside of the current criteria will be reinvested with the above criteria on maturity.*

**NB**

**Non-UK Banks** - *These should be restricted to a maximum exposure of 20% per country. This means that effectively all your authority's investments can be made with non-UK institutions should you wish, but it limits the risk of over-exposure to any one country.*

**MMFs** – Investments should be diversified including MMFs. We have been advised that, as far as is practicable, investments in Money Market Funds should be spread between two funds or more.

**Group Limits** - For institutions within a banking group, these are set at £20m.

*This is the list of our current counterparties. This is regularly updated in conjunction with our treasury advisers. No new investment is made without checking current status of counterparty with our treasury adviser. :*

<b>Instrument</b>	<b>Country/ Domicile</b>	<b>Counterparty</b>	<b>Maximum Counterpa rty Limit £m</b>	<b>Maximum Group Limit (if applicabl e) £m</b>	<b>Current Holding £m</b>
Term Deposits/Call Accounts	UK	Santander UK Plc (Banco Santander Group)	20	20	10
Term Deposits/Call Accounts	UK	Bank of Scotland (Lloyds Banking Group)	20	20	0
Term Deposits/Call Accounts	UK	Lloyds TSB (Lloyds Banking Group)	20	20	15
Term Deposits/Call Accounts	UK	Barclays Bank Plc	20	20	20
Term Deposits/Call Accounts	UK	Clydesdale Bank (National Australia Bank Group)	20	20	11
Term Deposits/Call Accounts	UK	HSBC Bank Plc	20	20	1
Term Deposits/Call Accounts	UK	Nationwide Building Society	20	20	0
Term Deposits/Call Accounts	UK	NatWest (RBS Group)	20	20	0
Term Deposits/Call Accounts	UK	Royal Bank of Scotland (RBS Group)	20	20	20
Term Deposits/Call Accounts	Australia	Australia and NZ Banking Group	20	20	0

Term Deposits/Call Accounts	Australia	Commonwealth Bank of Australia	20	20	0
Term Deposits/Call Accounts	Australia	National Australia Bank Ltd (National Australia Bank Group)	20	20	0
Term Deposits/Call Accounts	Australia	Westpac Banking Corp	20	20	0
Term Deposits/Call Accounts	Canada	Bank of Montreal	20	20	0
Term Deposits/Call Accounts	Canada	Bank of Nova Scotia	20	20	0
Term Deposits/Call Accounts	Canada	Canadian Imperial Bank of Commerce	20	20	0
Term Deposits/Call Accounts	Canada	Royal Bank of Canada	20	20	0
Term Deposits/Call Accounts	Canada	Toronto-Dominion Bank	20	20	0
Term Deposits/Call Accounts	Finland	Nordea Bank Finland	20	20	0
Term Deposits/Call Accounts	France	BNP Paribas	20	20	0
Term Deposits/Call Accounts	France	Credit Agricole CIB (Credit Agricole Group)	20	20	0
Term Deposits/Call Accounts	France	Credit Agricole SA (Credit Agricole Group)	20	20	0
Term Deposits/Call Accounts	France	Société Générale	20	20	0
Term Deposits/Call Accounts	Germany	Deutsche Bank AG	20	20	0
Term Deposits/Call Accounts	Netherlands	ING Bank NV	20	20	0
Term Deposits/Call Accounts	Netherlands	Rabobank	20	20	0

Term Deposits/Call Accounts	Sweden	Svenska Handelsbanken	20	20	0
Term Deposits/Call Accounts	Switzerland	Credit Suisse	20	20	0
Term Deposits/Call Accounts	US	JP Morgan	20	20	0

*We also currently hold a £5m investment with Dexia whose credit ratings are slightly below the level required to be included on our list for new investments. This investment is regularly monitored with our treasury advisers and currently poses no risk of default.*

*Please note this list could change if, for example, a counterparty/country is upgraded, and meets our other creditworthiness tools. Alternatively if a counterparty is downgraded, this list may be shortened.*

### Non-Specified Investments determined for use by the Council

Having considered the rationale and risk associated with Non-Specified Investments, the following have been determined for the Council's use:

	In-house use	Use by fund managers	Maximum maturity	Max % of portfolio	Capital expenditure?
<ul style="list-style-type: none"> <li>▪ Deposits with banks and building societies</li> </ul>	✓		<i>2 years</i>	100	No
<ul style="list-style-type: none"> <li>▪ CDs with banks and building societies</li> </ul>	✓	✓	<i>2 years</i>	50	
<ul style="list-style-type: none"> <li>▪ Gilts</li> <li>▪ Bonds issued by multilateral development banks</li> <li>▪ Bonds issued by financial institutions guaranteed by the UK government</li> <li>▪ Sterling denominated bonds by non-UK sovereign governments</li> </ul>	✓ (on advice from treasury advisor)	✓	<i>2 years</i>	50	No
Money Market Funds and Collective Investment Schemes, which are not credit rated	✓ (on advice from treasury advisor)	✓	<i>2 years</i>	25	No

Government guaranteed bonds and debt instruments issued by corporate bodies	✓	✓	2 years	25	Yes
Non-guaranteed bonds and debt instruments issued by corporate bodies	✓	✓	2 years	25	Yes
Pooled funds which are capital expenditure investments as defined by regulations.	✓ (on advice from treasury advisor)	✓	Nil	0	Yes

1. In determining the period to maturity of an investment, the investment should be regarded as commencing on the date of the commitment of the investment rather than the date on which funds are paid over to the counterparty.
2. The use of the above instruments by the Council's fund manager(s) will be by reference to the fund guidelines contained in the agreement between the Council and the individual manager.

**TOTAL RISK PER COUNTERPARTY AS AT 31 DECEMBER 2010**

	<b>CREDIT RATING</b>			<b>TOTAL £000</b>
<u>Fixed Deposits</u>				
Barclays	UK AAA	F1+AA-	B 1	20,000
Dexia	Belgium AA+	F1+A+	C/D 1	5,000
HSBC	UK AAA	F1+AA	B 1	900
Lloyds Bank	UK AAA	F1+AA-	C 1	15,000
Royal Bank of Scotland	UK AAA	F1+AA-	C/D 1	10,000
Santander	UK AAA	F1+AA-	B 1	10,000
Yorkshire Bank	UK AAA	F1+AA-	C 1	11,440
<b>TOTAL- FIXED TERM AND CASH DEPOSITS</b>				<b>72,340</b>
<u>Variable Deposits</u>				
Royal Bank of Scotland	UK AAA	F1+AA-	C/D 1	10,000
<b>TOTAL VARIABLE DEPOSITS</b>				<b>10,000</b>
<b><u>Total</u></b>				<b><u>82,340</u></b>

<b><u>SUMMARY BY SOVEREIGN RATING</u></b>	<b><u>£000</u></b>	<b><u>%</u></b>
UK AAA	77,340	93.9
BELGIUM AA+	5,000	6.1
<b>Total</b>	<b>82,340</b>	<b>100</b>

## Credit Ratings – A Guide.

### *Long-term credit ratings and Sovereign Ratings*

Fitch Rating' long-term credit ratings are set up along a scale from 'AAA' to 'D', first introduced in 1924 and later adopted and licensed by Standard & Poors (S&P).

Moody's also uses a similar scale, but names the categories differently. Like S&P, Fitch also uses intermediate modifiers for each category between AA and CCC (i.e., AA+, AA, AA-, A+, A, A-, BBB+, BBB, BBB- etc.).

### Investment grade

- **AAA** : the best quality, reliable and stable
- **AA** : good quality, a bit higher risk than AAA
- **A** : economic situation can affect finance
- **BBB** : medium class counterparties, which are satisfactory at the moment

### Non-investment grade

- **BB** : more prone to changes in the economy
- **B** : financial situation varies noticeably
- **CCC** : currently vulnerable and dependent on favorable economic conditions to meet its commitments
- **CC** : highly vulnerable, very speculative bonds
- **C** : highly vulnerable, perhaps in bankruptcy or in arrears but still continuing to pay out on obligations
- **D** : has defaulted on obligations and Fitch believes that it will generally default on most or all obligations
- **NR** : not publicly rated

### *Short-term credit ratings*

Fitch's short-term ratings indicate the potential level of default within a 12-month period.

- **F1+** : best quality grade, indicating exceptionally strong capacity of obligor to meet its financial commitment
- **F1** : best quality grade, indicating strong capacity of obligor to meet its financial commitment
- **F2** : good quality grade with satisfactory capacity of obligor to meet its financial commitment

- **F3** : fair quality grade with adequate capacity of obligor to meet its financial commitment but near term adverse conditions could impact the obligor's commitments
- **B** : of speculative nature and obligor has minimal capacity to meet its commitment and vulnerability to short term adverse changes in financial and economic conditions
- **C** : possibility of default is high and the financial commitment of the obligor are dependent upon sustained, favourable business and economic conditions
- **D** : the obligor is in default as it has failed on its financial commitments.

### **Bank Individual Ratings**

Individual Ratings are assigned to banks that are legal entities. The term "banks" here includes bank holding companies and bank assurance holding companies, bank assurance companies operating as single legal entities, investment banks and private banks. These ratings may also be assigned to leasing companies, instalment credit companies, credit card companies, brokerage houses, investment management companies and securities dealing companies, as circumstances demand. These ratings, which are internationally comparable, attempt to assess how a bank would be viewed if it were entirely independent and could not rely on external support. These ratings are designed to assess a bank's exposure to, appetite for, and management of risk, and thus represent the agency's view on the likelihood that it would run into significant financial difficulties such that it would require support.

- 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.
- D:** A bank that has weaknesses of internal and/or external origin. There are concerns regarding its profitability and balance sheet integrity, franchise, management, operating environment or prospects. Banks in emerging markets are necessarily faced with a greater number of potential deficiencies of external origin.
- E:** A bank with very serious problems, which either requires or is likely to require external support.
- F:** A bank that has either defaulted or, in Fitch Ratings' opinion, would have defaulted if it had not received external support. Examples of such support include state or local government support, (deposit) insurance funds,

acquisition by some other corporate entity or an injection of new funds from its shareholders or equivalent.

Notes: Gradations may be used among the ratings A to E: i.e. A/B, B/C, C/D, and D/E. No gradations apply to the F rating.

## **Support Ratings (1 – 5)**

### **The Purpose and Function of Support Ratings**

Support Ratings are Fitch Ratings' assessment of a potential supporter's propensity to support a bank and of its ability to support it. Its propensity to support is a judgment made by Fitch Ratings. Its ability to support is set by the potential supporter's own Issuer Default Ratings, both in foreign currency and, where appropriate, in local currency. Support Ratings do not assess the intrinsic credit quality of a bank. Rather they communicate the agency's judgment on whether the bank would receive support should this become necessary. These ratings are exclusively the expression of Fitch Ratings' opinion even though the principles underlying them may have been discussed with the relevant supervisory authorities and/or owners.

### **Timeliness and Effectiveness Requirements**

Fitch Ratings' Support Rating definitions are predicated on the assumption that any necessary "support" is provided on a timely basis. The definitions are also predicated on the assumption that any necessary support will be sufficiently sustained so that the bank being supported is able to continue meeting its financial commitments until the crisis is over.

### **Obligations and Financial Instruments Covered**

In terms of these definitions, unless otherwise specified, "support" is deemed to be in terms of foreign currency. It is assumed that typically the following obligations will be supported: senior debt (secured and unsecured), including insured and uninsured deposits (retail, wholesale and interbank); obligations arising from derivatives transactions and from legally enforceable guarantees and indemnities, letters of credit, and acceptances; trade receivables and obligations arising from court judgments.

Likewise, the agency does not assume that the following capital instruments will be supported when sovereign support is involved: preference/preferred shares or stock; hybrid capital (tier 1 and upper tier 2), including reserve capital instruments (RCIs) and variations upon RCIs; and common/ordinary equity capital. It is also assumed that there will be no support for any moral obligation on securitizations. The sovereign support status of subordinated debt is difficult to categorize in advance; it is assessed on a case by case basis, distinguishing among different jurisdictions.

### **Definitions:**

- 1:** 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:** 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:** 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-'.
- 4:** A bank for which there is a limited probability of support because of significant uncertainties about the ability or propensity of any possible provider of support to do so. This probability of support indicates a minimum Long-Term Rating floor of 'B'.
- 5:** A bank for which external support, although possible, cannot be relied upon. This may be due to a lack of propensity to provide support or to very weak financial ability to do so. This probability of support indicates a Long-Term Rating floor no higher than 'B-' and in many cases no floor at all.

**GLOSSARY**

<b>Term</b>	<b>Meaning</b>
Affordable Borrowing Limit	The amount the authority would normally borrow at any point of time in the year. This boundary might be exceeded temporarily but only in exceptional circumstances. The limit is set by Full Council at the beginning of March and is a prudential indicator.
Authorised Borrowing Limit	The maximum amount the authority can borrow at any point of time in the year. This limit should never be exceeded. The limit is set by Full Council at the beginning of March and is a prudential indicator.
Capital Financing Requirement (CFR)	This represents the underlying need for the authority to borrow and represent the assets of the authority less the long term capital liabilities.
Credit Default Swaps (CDS)	CDS are bought by investors to insure against defaults (i.e. the counterparty not being able to repay). The higher the cost/premium then the higher the risk – CDS therefore given a market view of the credit worthiness of an organisation.
Credit Ratings	Rating on the ability of an organisation to meet its obligations; ratings are assigned by independent, specialist companies, such as Fitch and Moodys using market intelligence they gather.
Credit Risk	The risk that the debtor will default on their obligations
Counterparty	The organisation that your are conducting your business with.
Debt Management Account Deposit Facility	Provided by the <a href="#">Debt Management Office</a> , users can place cash in secure fixed-term deposits. Deposits are guaranteed by the government and therefore have the equivalent of a sovereign triple-A credit rating.

Discounts	These relate to Public Works Loans Board loans. If rates have increased since the borrowing was undertaken then part of the benefit that PWLB will achieve from being able to loan out at that higher rate are passed back to an authority if they repay the loan early.
Fund Managers	Independent investment managers who work to a specific mandate and invest funds on behalf of the Council
Inflation	The rise in prices of goods and services over a period of time.
Interest Rate Risk	The risk that the value of an investment will change due to changes to the interest rate.
Internal Borrowing	This is where the amount of an authority's borrowing is less than it's CFR or underlying need to borrow and represents the use of internal balances rather than borrowing from the market.
LIBID	London inter-bank bid rate. Interest rate at which prime banks will <b>borrow</b> money in the London inter-bank market.
LIBOR	London inter-bank offer rate. Interest rate at which prime banks will <b>lend</b> money in the London inter-bank market. Fixed every day by the British Bankers Association to five decimal places.
Liquidity Risk	The risk of not being able to trade an investment quickly to release cash.
Obligor	An individual or company that owes debt to another individual or company (the creditor), as a result of borrowing or issuing bonds.
Premia	The is the penalty applied to the early redemption of PWLB loans where rates have fallen since the loan was undertaken.
Prudential Code	A professional code of practice which provides regulatory framework to local authorities on capital expenditure,

	investments and borrowing activities.
Prudential Indicators	A set of indicators developed within the Prudential Code which define thresholds for investment and borrowing within a local authority.
PWLB	Public Works Loans Board – a Government agency providing long and short term loans to local authorities. Interest rates are generally lower than the private sector and slightly higher than the rates at which the Government themselves may borrow.
Re-scheduling	This relates to repaying existing borrowing early and replacing it with borrowing for a different period usually, but not necessarily, at lower rates
Return	The gain from holding an investment over a given period
Security	An investment instrument, other than an insurance policy or fixed annuity, issued by a corporation, government or other organisation which offers evidence of debt or equity.
Sovereign Exposure	Risk of exposure to one particular country.
Supranational Bonds	These are bonds (similar to gilts) issued by multi government development organisations and are supported by all of the governments who form part of the organisation. E.g European Investment Bank and are usually very secure.
Quantative Easing	This is where the government buy back there own gilt issuance to effectively pump money into the financial markets of the economy.