APPENDIX 2

**TREASURY MANAGEMENT STRATEGY STATEMENT and ANNUAL INVESTMENT STRATEGY 2012/2013**

**TREASURY MANAGEMENT STRATEGY STATEMENT**

## 1. Introduction

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

The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (AIS) (as required by Investment Guidance issued subsequent to the Act). The AIS sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The suggested strategy for 2012/13 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisors, Arlingclose Ltd. The strategy covers:

- treasury limits in force which will limit the treasury risk and activities of the Council;
- Prudential Indicators;
- the current treasury position;
- prospects for interest rates;
- the borrowing requirement;
- the borrowing strategy;
- Housing Revenue Account Self Financing
- debt rescheduling;
- the investment strategy;
- Annual MRP statement
- Other items

There is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from: -

a) increases in interest charges caused by increased borrowing to finance additional capital expenditure, and

b) any increases in running costs from new capital projects are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

## 2. Treasury Limits for 2012/13 to 2014/15

There is a statutory duty under S.3 of the Local Government Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit".

The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is ‘acceptable’.

Whilst termed an “Affordable Borrowing Limit”, the capital plans to be considered for inclusion incorporate financing by external borrowing. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and the two successive financial years.

## 3. Prudential Indicators for 2010/11 – 2014/15

3.1.1 The Council is also required to indicate that it has adopted the CIPFA Code of Practice on Treasury Management. This was adopted in February 2002 by full Council.

The following prudential indicators are relevant for the purposes of setting an integrated treasury management strategy.

3.1.2 The Council must estimate its total capital expenditure, split between the Housing Revenue Account (HRA) and non HRA, in the next three or more financial years. 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.

3.1.3 The actual capital expenditure that was incurred in 2010/11 and the estimates of capital expenditure to be incurred for the current and future years that are recommended for approval are:-

| **Capital Expenditure** | | | | | |
|---|---|---|---|---|---|
| Proposed Capital programme | 2010/11 £000 Actual | 2011/12 £000 Revised | 2012/13 £000 Estimate | 2013/14 £000 Estimate | 2014/15 £000 Estimate |
| General Fund | 3,254 | 9,244 | 9,829 | 1,116 | 1,056 |
| HRA | 3,851 | 4,989 | 5,192 | 5,905 | 6,080 |
| Total | 7,105 | 14,233 | 15,021 | 7,021 | 7,136 |

### 3.1.4 Estimates of the ratio of financing costs to the net revenue stream

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 borrowing costs. It would not be prudent for borrowing costs to be a significant proportion of net revenue either now or in the future. By estimating the ratio for at least the next three years the trend in the cost of capital (borrowing costs net of interest and investment income) as a proportion of revenue income can be seen.

3.1.5 Estimates of the ratio of financing costs to net revenue stream for the current and future years, and the actual figures for 2010/11 are:

| **Ratio of Financing Costs to Net Revenue Stream** | | | | | |
|---|---|---|---|---|---|
| | 2010/11 Actual % | 2011/12 Revised % | 2012/13 Estimate % | 2013/14 Estimate % | 2014/15 Estimate % |
| Non-HRA | 4.09 | 5.28 | 3.85 | 3.52 | 2.71 |
| HRA | 2.31 | 2.54 | 10.65 | 10.10 | 9.69 |

3.1.6 **Capital Financing Requirement (CFR)**

The Capital Financing Requirement measures the authority's underlying need to borrow for a capital purpose. The authority has an integrated treasury management strategy and has adopted the CIPFA Code of Practice for Treasury Management in the Public Services. Cheltenham Borough Council has, at any point in time, a number of cashflows both positive and negative, and manages its treasury position in terms of its borrowings and investments in accordance with its approved treasury management strategy and practices. In day to day cash management, no distinction can be made between revenue cash and capital cash. External borrowing arises as a consequence of all the financial transactions of the authority and not simply those arising from capital spending.

The HRA reforms which come into effect for 2012/13 will determine which current loans the Council has, will either be apportioned to the General Fund or HRA. The Council has focused on a "two pool" approach which earmarks a proportion of the loans based on the HRA CFR as of 1st April 2011.

3.1.7 The Council can borrow without limit, provided it ensures such borrowing is affordable, prudent and sustainable.

3.1.8 Estimates of the end of year capital financing requirement for the authority for the current and future years and the actual capital financing requirement at 31st March 2011 are:

| Capital Financing Requirement (CFR) | | | | | |
|---|---|---|---|---|---|
| | 31/3/11<br>£000<br>Actual | 31/3/12<br>£000<br>Revised | 31/3/13<br>£000<br>Estimate | 31/3/14<br>£000<br>Estimate | 31/3/15<br>£000<br>Estimate |
| Non-HRA | 26,760 | 27,354 | 30,013 | 29,111 | 28,219 |
| HRA | 18,728 | 46,142 | 44,750 | 44,750 | 44,750 |
| Total CFR | 45,488 | 73,496 | 74,763 | 73,861 | 72,969 |

As a result of the HRA Subsidy Reform, the Capital Financing Requirement has risen significantly in 2011/12 as the Council is due to borrow £27.414m in March 2012 to pay over to the DCLG. Further information on the HRA reforms can be found in section 8.

3.1.9 **Net borrowing and the Capital Financing Requirement**

CIPFA's Prudential Code for Capital Finance in Local Authorities includes the following as 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 capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years."

3.1.10 Local authorities may borrow temporarily to cover cash flow shortages but over the medium term should only borrow to finance capital expenditure.

3.1.11 In order to ensure that over the medium term net borrowing will only be for capital purposes, the Council needs to ensure its net external borrowing does not exceed its

Capital Financing Requirement over the current and next three years. The table below demonstrates that the estimated level of net investments remains lower than the capital financing requirement in each year, and therefore meets this requirement.

| Estimated net borrowing and capital financing requirement at Year end | 2010/11 £000 Actual | 2011/12 £000 Revised | 2012/13 £000 Estimate | 2013/14 £000 Estimate | 2014/15 £000 Estimate |
|---|---|---|---|---|---|
| Gross borrowing | 50,133 | 72,706 | 75,298 | 74,753 | 74,224 |
| Investments | 15,759 | 6,485 | 5,785 | 4,985 | 4,285 |
| Net (Investment) / borrowing | 34,374 | 66,221 | 69,513 | 69,768 | 69,939 |
| Capital financing requirement | 45,437 | 73,496 | 74,763 | 73,861 | 72,969 |

3.1.12 **Gross and Net Debt**

3.1.13 The purpose of this treasury indicator is to highlight a situation where the Council is planning to borrow in advance of need.

| Gross and Net Debt | 2011/12 £000 Revised | 2012/13 £000 Estimate | 2013/14 £000 Estimate | 2014/15 £000 Estimate |
|---|---|---|---|---|
| Gross Debt | 63,673 | 66,265 | 65,720 | 65,191 |
| Investments | 6,485 | 5,785 | 4,985 | 4,285 |
| Net Debt | 57,188 | 60,480 | 60,735 | 60,906 |

3.1.14 **Estimates of the incremental impact of capital expenditure on council tax and housing rents**

A fundamental indicator of the affordability of capital expenditure plans is its impact on council tax and housing rents. Any borrowing for capital purposes has an impact on the revenue account and, to the extent that it is not supported by government or other contributions, on council tax and/or housing rents. Using capital receipts to fund capital expenditure also has an impact because the assets sold would no longer generate rental income or investment income. The use of revenue funding to fund capital expenditure clearly has a direct impact on the revenue account and council tax/rents. The completed capital schemes will also have an impact in terms of running costs and income generation.

3.1.15 The Council must estimate the incremental impact of its capital expenditure plans (shown above) on the council tax and housing rents for the next three years or more.

3.1.16 The estimate of the incremental impact of capital investment decisions proposed in this budget report, over and above capital investment decisions that have previously been taken by the Council are:

For the Band D Council Tax –

| 2012/13 | 2013/14 | 2014/15 |
|---|---|---|
| £Nil* | £Nil | £Nil |

* As a proposed Council Tax freeze for 2012/13.

For average weekly housing rents

| 2012/13 | 2013/14 | 2014/15 |
|---|---|---|
| Nil** | Nil** | Nil** |

** Decisions on annual rent increases are subject to rent restructuring guidelines set by Central Government. As a consequence the Government has indicated that rent levels will increase annually by Retail Price Index plus 0.5% and this should cover all additional capital expenditure. This method has been used to form part of the 30 year HRA Business Plan.

### 3.2 External Debt Indicators

Two limits need to be set and monitored to ensure borrowing is prudent, affordable and sustainable.

### 3.2.1 Authorised Limit

The Council must set an authorised limit for its external debt for the next three financial years or more. This is

- the possible maximum level of borrowing that may need to be incurred and the limit beyond which borrowing will be prohibited
- the statutory limit specified in section 3(1) of the Local Government Act 2003
- Reflects a level of borrowing which, although affordable in the short term may not be sustainable
- The ‘outer boundary’ of the Council’s possible need to borrow.

3.2.2 In respect of its external debt, it is recommended that the Council approves the following authorised limits for its total external debt gross of investments for the next three financial years. The Council is asked to approve these limits and to delegate authority to the Director of Resources (Designated Section 151 Officer) within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities ( in accordance with option appraisal and best value for money for the authority).

| **Authorised Limit for External Debt** | | | | |
|---|---|---|---|---|
| | 2011/12 £000 | 2012/13 £000 | 2013/14 £000 | 2014/15 £000 |
| Borrowing | 109,000 | 109,000 | 109,000 | 109,000 |
| Other long term liabilities | - | - | - | - |
| Total | *109,000 | 109,000 | 109,000 | 109,000 |

*The Authorised Limit was increased and approved from £81m to £109m at Council in December 2011 as a consequence of the increase in debt due in March 2012 to repay the DCLG £27.414m as part of the HRA Self Financing reforms.

3.2.3 In setting the limit, account must be taken of the authority's current commitments, existing plans and the proposals in the budget report for capital expenditure and financing, and with its approved treasury management policy statement and practices. Risk analysis has been taken into account, as have plans for capital expenditure, estimates of the capital financing requirement and estimates of cash flow requirements.

This limit represents the worst case scenario, i.e. the effect on the cash flow of receiving no council tax income and borrowing to the maximum of the capital financing requirement, in addition to investments held. The calculation follows a prescribed formula and is in excess of the expected levels of borrowing for 2012/13 to 2014/15 in accordance with Treasury strategy and as shown in the Operational Boundary indicator in paragraph 3.2.6.

3.2.4 In taking its decisions on this report, the Council is asked to note that the authorised limit determined for 2012/13 is the statutory limit determined under section 3(1) of the Local Government Act 2003.

3.2.5 **Operational Boundary**

The Council is also asked to approve the following operational boundary for external debt for the same time period. The proposed operational boundary for external debt is based on the same estimates as the authorised limit but reflects directly the estimate of the most likely, prudent but not worst case scenario, without the additional headroom included within the authorised limit to allow for example for unusual cash movements. The operational boundary represents a key management tool for in year monitoring. Within the operational boundary, figures for borrowing and other long term liabilities are separately identified. The Council is also asked to delegate authority to the Director of Resources (Designated Section 151 Officer), to effect movement between separately agreed figures for borrowing and other long term liabilities, in a similar fashion to the authorised limit.

3.2.6 The boundary may be breached occasionally due to unexpected cash flow shortages but a sustained breach would indicate the Council may be in danger of breaching the Authorised Limit. The Council is recommended to approve the following limits for this indicator.

| Operational Boundary for External Debt | | | | |
|---|---|---|---|---|
| | 2011/12 £000 | 2012/13 £000 | 2013/14 £000 | 2014/15 £'000 |
| Borrowing | 99,000 | 96,000 | 98,500 | 98,200 |
| Other long term liabilities | - | - | - | - |
| Total | 99,000 | 96,000 | 98,500 | 98,200 |

The Operational Boundary for borrowing was increased and approved from £71m to £99m at Council in December 2011 as a consequence of the increase in debt due in March 2012 to repay the DCLG £27.414m as part of the HRA Self Financing reforms.

3.2.7 The operational boundary represents the maximum expected operational borrowing at a given time, which is significantly lower than the prescribed authorised limit shown in paragraph 3.2.2. This measure reflects a more realistic view of likely cash flow scenarios and should not be exceeded.

3.2.8 The Council's actual external debt at 31st March 2011 was £50.133 million. It should be noted that actual external debt is not directly comparable to the authorised limit and operational boundary, since the actual external debt reflects the position at one point in time.

3.3. **Upper limits on interest rate exposure**

The Council must set upper limits on its exposure to changes in interest rates for at least the next three years. An upper limit must be set for both fixed and variable rates covering both borrowing and investments.

3.3.1 The purpose of these indicators is to reduce the likelihood of an adverse movement in interest rates or borrowing / investment decisions impacting negatively on the Council's overall financial position.

3.3.2 It is recommended that the Council sets an upper limit on its fixed interest rate exposures for 2012/13, 2013/14 and 2014/15 of its gross outstanding borrowing.

3.3.3 It is further recommended that the Council sets an upper limit on its variable interest rate exposures for 2012/13, 2013/14 and 2014/15 of 100% of its gross outstanding borrowing.

3.3.4 This means the Director of Resources (Designated Section 151 Officer) will manage fixed interest rate exposures within the range 0% to 100% and variable interest rate exposures within the range 0% to 100%.

3.3.5 **Maturity structure of borrowing**

The Council must set both upper and lower limits with respect to the maturity structure of borrowing for the following financial year. This indicator is designed to be a control over an authority having large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates. Therefore the aim should be a relatively even spread of debt repayment dates.

3.3.6 It is recommended that the Council sets upper and lower limits for the maturity structure of its borrowings as follows:

Amount of projected borrowing that is fixed rate maturing in each period is:

| | Upper Limit % | Lower Limit % |
|---|---|---|
| Under 12 months | 50 | 0 |
| 12 months and within 24 months | 50 | 0 |
| 24 months and within 5 years | 100 | 0 |
| 5 years and within 10 years | 100 | 0 |
| 10 years and within 20 years | 100 | 0 |
| 20 years and within 30 years | 100 | 0 |
| 30 years and within 40 years | 100 | 0 |
| 40 years and within 50 years | 100 | 0 |
| 50 years and above | 100 | 0 |

4. **Current Portfolio Position**
The Council's treasury debt portfolio position at 31st December 2011 comprised:

| | | Principal £m | | Ave. rate % |
|---|---|---|---|---|
| Fixed rate borrowing | PWLB | 12.40 | | 4.75 |
| | Market | 15.90 | 28.30m | 4.00 |
| Variable rate borrowing | PWLB | 0 | | |
| | Market | 0 | | |
| Temporary Borrowing | | | 8.0m | 0.36 |
| **TOTAL DEBT** | | | **36.30m** | **3.46** |
| **TOTAL INVESTMENTS** | | | **17.41m** | **3.06** |

5. **Outlook for Interest Rates**

5.1 The Bank of England has now held interest rates at 0.5% since March 2009, its lowest level in its 316 year history as part of a continued effort to aid an economic recovery. The Bank of England stated that interest rates will be on hold through to the end of 2012. This impact on investment income has been factored into 2012/13 investment budgets.

5.2 Part of the service offered by the Council's treasury advisers, Arlingclose Ltd, is to assist the Council to formulate a view on interest rates. The Authority will reappraise its strategies from time to time in response to evolving economic, political and financial events.

The following table gives Arlingclose Ltd view on future interest rates:

| | Mar-12 | Jun-12 | Sep-12 | Dec-12 | Mar-13 | Jun-13 | Sep-13 | Dec-13 | Mar-14 | Jun-14 | Sep-14 | Dec-14 | Mar-15 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Official Bank Rate** | | | | | | | | | | | | | |
| **Upside risk** | | | | | 0.25 | 0.50 | 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** | 0.50 | 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** | 1.75 | 1.75 | 1.75 | 1.75 | 1.80 | 1.85 | 1.95 | 2.00 | 2.10 | 2.20 | 2.30 | 2.40 | 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** | 1.30 | 1.35 | 1.40 | 1.50 | 1.60 | 1.70 | 1.80 | 2.00 | 2.10 | 2.30 | 2.40 | 2.50 | 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 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| **Central case** | 2.30 | 2.40 | 2.45 | 2.50 | 2.55 | 2.60 | 2.70 | 2.75 | 2.80 | 2.85 | 2.90 | 3.00 | 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 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| **Central case** | 3.05 | 3.05 | 3.10 | 3.20 | 3.25 | 3.30 | 3.35 | 3.40 | 3.45 | 3.50 | 3.60 | 3.75 | 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** | 0.50 | 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** | 3.40 | 3.50 | 3.60 | 3.70 | 3.80 | 3.90 | 4.00 | 4.00 | 4.00 | 4.10 | 4.20 | 4.25 | 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 |

5.3 **Outlook for the Economy**

Financial market stress is expected to remain a feature of 2012. Rates within the inter-bank markets (where banks fund the majority of their day to day operations) have continued to climb. This occurrence was a characteristic of the 2008 banking crisis and whilst the UK and European Central banks have flooded the markets with liquidity, it is still a strong indicator of market risk.

Inflation has moderated back to 4.2% in December 2011. Consumer Price Inflation (CPI) is expected to drop gradually back towards the 2% target as the January 2011 VAT increase, the surge in oil prices and the large energy price hikes fall out of the twelve month comparison.

Faltering global growth will not be helped by the considerable uncertainty and expansion of risks presented by the crisis in the Eurozone and gridlock in the United States going into an election year.

6. **Borrowing Strategy**

6.1 The Council prefers to maintain maximum control over its borrowing activities as well as flexibility on its loan portfolio. A prudent and pragmatic approach to borrowing will be maintained to minimise borrowing costs without compromising longer-term stability of the portfolio, consistent with the Council's Prudential Indicators. In conjunction with advice from its treasury advisor, Arlingclose Ltd, the Director Resources will keep under review the options it has in borrowing from the PWLB, the market and other sources.

Any borrowing undertaken and the timing will depend on capital expenditure levels, interest rate forecasts and market conditions during the year in order to minimise borrowing costs. The Council will be advised by Arlingclose Ltd on the specific timing of borrowing. The overall borrowing must be within the Council's projected Capital Financing Requirement (CFR) and its approved Affordable Borrowing Limit.

7**. Debt Rescheduling**

The Council will continue to maintain a flexible policy for debt rescheduling. Market volatility may provide opportunities for rescheduling debt from time to time. The rationale for rescheduling would be one or more of the following:

- Savings in interest costs with minimal risk
- Balancing the ratio of fixed to variable debt
- Amending the profile of maturing debt to reduce inherent refinancing risks.

Any rescheduling activity will be undertaken following the rationale within the Council's Treasury Management Strategy. The Director of Resources (Designated Section 151 Officer) will agree in advance with Arlingclose Ltd the strategy and framework within which debt will be repaid/rescheduled if opportunities arise. Thereafter the Council's debt portfolio will be monitored against equivalent interest rates and available refinancing options on a regular basis. As opportunities arise, they will be identified by Arlingclose Ltd and discussed with the Council's officers.

All rescheduling activity will comply with the accounting requirements of the local authority Code of Practice and regulatory requirements of the Capital Finance and Accounting Regulations (SI 2007 No 573 as amended by SI 2008/414).

All rescheduling and any new long term borrowing undertaken will be reported to the Treasury Management Panel at the meeting following its action.

8. **Housing Revenue Account Self Financing – Managing HRA Debt**

8.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) published its 2011 Edition of 'Treasury Management in the Public Services – Guidance Notes for Local Authorities' to include a new section with regard to Treasury Management implications of the housing self-financing reform. The principles set out by CIPFA upon which the allocation of loans should be based are as follows:-

- 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 changes 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 Capital Financing Requirement (CFR) are properly identified between General Fund and HRA.

8.2 The reforms involve a removal of the housing subsidy system by offering a one-off reallocation of debt. The settlement of the reallocation is expected to take place on 28th March 2012 and will result in the Authority having an increase in debt to fund the settlement of £27.414m which will be clearly attributable to the HRA. The specific borrowing amount and terms will be determined by the Authority in conjunction with the HRA 30 year Business Plan and the advice of its treasury advisers, Arlingclose Ltd.

8.3 Current loans have been split on the “two pool” approach which identifies loans which will be allocated to the HRA based on the drawdown to fund the HRA CFR. This has been adopted for clarity and transparency. Treasury management decisions on the structure and timing of borrowing will be made independently for the General Fund and HRA. Interest on loans will be calculated in accordance with proper accounting practices. This will require interest expenditure on external borrowing attributed to HRA loans being allocated to the HRA. Interest expenditure on external borrowing attributed to the general Fund will be allocated to the General Fund. Third party loans taken out on behalf for Cheltenham Borough Homes, Gloucestershire Airport and the Everyman Theatre have been excluded from the “two pool” approach.

## 9. Sources of Borrowing

9.1 In conjunction with advice from its treasury advisor, Arlingclose Ltd, the Authority will keep under review the following borrowing sources:

- PWLB
- Local authorities (includes Police & Fire authorities)
- Commercial banks
- Money Markets
- Leasing

9.2 The cost of carry has resulted in an increased reliance upon shorter dated and variable rate borrowing. This type of borrowing injects volatility into the debt portfolio in terms of interest rate risk but is counterbalanced by its affordability and alignment of borrowing costs with investment returns. The Authority’s exposure to shorter dated borrowing is kept under regular review and if margins change then the borrowing strategy could be maintained or altered. It has been a policy recently for the Council to use maturing investments to repay temporary debt, which removes some of the interest rate risk in the future.

9.3 The Authority has £15.9 million exposure to LOBO loans (Lender’s Option Borrower’s Option) of which £7 million can be “called” within 2012/13. A LOBO can be called when the lender exercises its rights to amend the interest rate on the loan at which point the Borrower can accept the revised terms or reject them and repay the loan. LOBO loans present a potential refinancing risk to the Council since the decision to call a LOBO is entirely at the lenders discretion. Any LOBOs called will be discussed with the treasury advisers prior to acceptance of any revised terms.

# ANNUAL INVESTMENT STRATEGY

## 10. Investment Policy

The Council will have regard to the CLG’s Guidance on Local Government Investments (“the Guidance”) issued in March 2010 and CIPFA’s Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). 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.

Credit markets remain in a state of distress as a result of the excessive and poor performing debt within the financial markets and in some instances this has lead to a sovereign debt crisis (in countries such as Greece and Italy) with the outcome still largely unknown. It is against this backdrop of uncertainty that the Authority's investment strategy is framed.

As such it is important to restate the overall policy objective of the Annual Investment Strategy i.e. that:

> **'the council should invest prudently the surplus funds held on behalf of the community giving priority to security and liquidity'.**

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

Investment instruments identified for use in the financial year are listed below under the 'Specified' Investments heading.

**Specified investments** are investments offering high security and high liquidity. The investments will be sterling denominated with maturities up to a revised maximum of 1 year and meet the minimum 'high' credit rating criteria where applicable.

## SPECIFIED INVESTMENTS

**All 'Specified Investments' listed below must be sterling-denominated.**

The types of investments that will be used by the Council

| Investment | Max Sum per institution/group | Maximum period |
|---|---|---|
| **Debt Management Agency Deposit Facility*** (DMADF)<br>• this facility is at present available for investments up to 6 months | UNLIMITED | 6 months |
| **Term deposits** with the UK government or with UK local authorities (i.e. local authorities as defined under Section 23 of the 2003 Act) with maturities up to 1 year | £5m | 1 year |
| **Term deposits** with credit-rated deposit takers (banks and building societies), including callable deposits, with maturities up to 1 year | £4m - £7m | 1 year |
| **AAA rated Money Market Funds** with UK/Ireland/Luxembourg domiciled | £1m | 1 year |
| * **T-Bills** issued by the DMO (Government) | UNLIMITED | 1 year |

* T-Bills issued by the government's DMO have been recommended by Arlingclose as another specified investment to have on the council's lending list.

**Non-specified investments** are of greater potential risk and cover deposit periods over one year. To protect against any potential defaults with any bank, after receiving advice from Arlingclose Ltd it is prudent not to lend any monies to any banks or building societies at present beyond a year. The exception to this is the loan made to Gloucestershire Airport Company which the Council could lend up to three years. The Council does have a 50% share in the airport.

11. **Lending criteria**

11.1 **Credit ratings**

The credit crisis has focused attention on the treasury management priority of security of capital monies invested. An authorised 'counter party lending' list is maintained by the treasury team on behalf of the Director, Resources (Delegated Section 151 Officer) which includes those counterparties which meet the minimum criteria for lending. The Council will use Fitch, Moody's and Standard and Poor ratings to derive its criteria for lending. CIPFA suggests using the lowest rating from all three of the agencies to determine creditworthy counterparties, plus additional market information. On the advice of Arlingclose Ltd in order to minimise risk, the Council will restrict lending to those institutions which meet the following minimum criteria, defined as:

**Moody's ratings:**
Aaa – A3 are judged to be of the highest quality, with minimal credit risk for long term investments. The ratings may be modified by the addition of a 1, 2 or 3 to show relative standing within the category where the highest within the rating is 1 and 3 the lowest.

P-1 - Banks having this rating offer superior credit quality and a very strong capacity for timely payment of short-term deposit obligations.

**Fitch ratings:**
AAA - A– Implies a bank with very high credit quality and denotes expectations of very low credit risk. They indicate very strong capacity for payment of long term financial commitments. The ratings may be modified by the addition of – or + where a + is higher rated within this category.

F1+ - Indicates the strongest capacity for timely payment of short term financial commitments.

**S&P ratings:**
AAA - A– Implies a bank with very high credit quality and denotes expectations of very low credit risk. They indicate very strong capacity for payment of long term financial commitments. The ratings may be modified by the addition of – or + where a + is higher rated within this category.

A-1+ - Indicates the strongest capacity for timely payment of short term financial commitments.

The 2011/12 approved strategy only allowed deposits with financial institutions with a minimum rating of A+/A1. It is the Councils intention to adopt the new credit rating criteria for the remainder of 2011/12 on approval of this strategy.

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The Council is alerted to changes in Fitch, Moody's and Standard & Poor's ratings through its treasury management advisors, Arlingclose Ltd. If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as an investment will be withdrawn immediately. Likewise if a counterparty/investment scheme is upgraded and meets the lending criteria then it will be added to the 'counterparty lending list'.

The Council will monitor and update the credit standing of the institutions on a regular basis. It will not simply rely on credit ratings but will also consider alternative assessments of credit strength i.e. Statements of government support and information on corporate developments or market sentiment towards investment counterparties.

11.2 **Size of deposits**

In reviewing the lending criteria in view of the current market situation and based upon advice from Arlingclose Ltd the Council has restricted the lending list to a small number of very low risk counterparties. As such the following is recommended:

The current authorised lending list meeting the criteria is as follows:

**TABLE 3 CURRENT COUNTERPARTY LENDING LIST & LIMITS**

| BANKS | COUNTRY | LONG TERM | | | SHORT TERM | | | LIMIT | MAX |
|---|---|---|---|---|---|---|---|---|---|
| | | Fitch | Moody's | S&P | Fitch | Moody's | S&P | £ | TIME |
| Bank of Scotland (Lloyds Banking group) | GB | A | A1 | A | F1 | P-1 | A-1 | 7,000,000 | 1 year |
| Barclays Bank plc | GB | A | Aa3 | A+ | F1 | P-1 | A-1 | 7,000,000 | 1 year |
| HSBC Bank plc | GB | AA | Aa2 | AA- | F1+ | P-1 | A-1+ | 7,000,000 | 1 year |
| Lloyds TSB (Lloyds Banking Group) | GB | A | A1 | A | F1 | P-1 | A-1 | 7,000,000 | 1 year |
| Nat West Bank (RBS Group) | GB | A | A2 | A | F1 | P-1 | A-1 | 7,000,000 | 1 year |
| Royal Bank of Scotland (RBS Group) | GB | A | A2 | A | F1 | P-1 | A-1 | 7,000,000 | 1 year |
| Standard Chartered Bank | GB | AA- | A1 | AA- | F1+ | P-1 | A-1+ | 7,000,000 | 1 year |
| Santander UK PLC – Call Account | GB | A+ | A1 | AA- | F1 | P-1 | A-1+ | 4,000,000 | Instant Access |
| **BUILDING SOCIETIES** | **COUNTRY** | **LONG TERM** | | | **SHORT TERM** | | | **LIMIT** | **MAX** |
| | | Fitch | Moody's | S&P | Fitch | Moody's | S&P | £ | TIME |
| Nationwide | GB | A+ | A2 | A+ | F1 | P-1 | A-1 | 7,000,000 | 1 year |
| **GOVT & LOCAL GOVERNMENT** | **COUNTRY** | **LONG TERM** | | | **SHORT TERM** | | | **LIMIT** | **MAX TIME** |
| | | Fitch | Moody's | S&P | Fitch | Moody's | S&P | £ | |
| Debt management account/T Bills | GB | N/A | N/A | N/A | N/A | N/A | N/A | unlimited | 1 year |
| UK local authorities | GB | N/A | N/A | N/A | N/A | N/A | N/A | 5,000,000 | 1 Year |
| Cheltenham Festivals | GB | N/A | N/A | N/A | N/A | N/A | N/A | 100,000 | 1 Year |

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| OTHER | COUNTRY | LONG TERM | | | SHORT TERM | | | LIMIT | TIME |
|---|---|---|---|---|---|---|---|---|---|
| | | Fitch | Moody's | S&P | Fitch | Moody's | S&P | £ | |
| Gloucestershire Airport | GB | N/A | N/A | N/A | N/A | N/A | N/A | 1,550,000 | 3 Years |
| Gloucestershire Everyman Theatre | GB | N/A | N/A | N/A | N/A | N/A | N/A | 1,000,000 | 2 Years |
| Cheltenham Borough Homes | GB | N/A | N/A | N/A | N/A | N/A | N/A | 5,000,000 | 2 Years |
| AAA Rated Money Market Funds | | AAA | AAA | AAA | AAA | AAA | AAA | 1,000,000 | Instant Access |
| *UBICO (LA Company) | GB | N/A | N/A | N/A | N/A | N/A | N/A | 500,000 | 1 Year |

* UBICO is being set up to be run as a Local Authority Company from 1st April 2012. From time to time to assist the LA Company daily cash-flow the council will be required to lend monies to them on a similar basis to what already occurs with Cheltenham Borough Homes.

The Council's shorter term cash-flow investments are made with reference to the outlook for the UK Bank Rate and money markets. For these monies, the Council will mainly utilise its business reserve accounts, Money Market Funds, Government's Debt Management Office (including T Bills) and Term deposits with UK Banks in 2012/13. The maximum duration for any deposit to be made to the above financial institutions is one year apart from those highlighted in the "other" category. These periods can be reduced if the ratings of that institution are downgraded. Treasury officers will take on board Arlingclose's recommendations when it is received.

11.3 **Council's Banker**

The Council banks with LloydsTSB (Lloyds Banking Group). On adoption of this Strategy, it will meet the minimum credit criteria of A- (or equivalent) long term. It is the Councils intention that even if the credit rating of LloydsTSB falls below the minimum criteria A- the bank will continue to be used for short term liquidity requirements (overnight and weekend investments) and business continuity arrangements.

11.4 **Money Market Funds (MMFs)**

Money Market Funds 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. Currently the Council has no MMF's but they have been recommended to us by Arlingclose as another investment tool. We will be looking to open at least three of them when the Strategy is approved.

11.5 **The Use of Financial Instruments**

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

12. **Annual Minimum Revenue Provision (MRP) Statement**

The annual MRP Statement is disclosed in Appendix 3.

13. **Balanced Budget Requirement**

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

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14. **Reporting on the Treasury Outturn**

The Director of Resources, (Designated Section 151 Officer) will report to Council on its treasury management activities and performance against the strategy at least twice a year, one at mid year and a year end review at closedown time.

The Treasury Management Panel will be responsible for the scrutiny of treasury management activity and practices.

15. **Other Items**

15.1 **Training**

In CIPFA's Code for Treasury Management, it requires the Director of Resources (Designated Section 151 Officer) to ensure that all appropriate staff and 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. Training requirements will be identified and any shortfalls will be met by Arlingclose Ltd or other organisations.

15.2 **Treasury Advisors**

The CLG's Guidance on local government investments recommend that the Investment Strategy should state:

- Whether and, if so, how the authority uses external advisors offering information, advice or assistance relating to investment and
- How the quality of any such service is controlled.

15.3 The Council's external advisor on Treasury Management is Arlingclose Ltd, who can provide us with information, advice and assistance in all areas of treasury. The Council has a close working relationship with Arlingclose and are in contact with their advisors on a regular basis (weekly) and daily if necessary. A detailed schedule of services is listed within the contract.