Appendix A

Economic Background 1st April 2014 to 30th September 2014

Growth in the UK continues, with unemployment falling and inflation remaining below the Monetary Policy Committee's (MPC) target of 2% p.a. However, growth is not felt to be robust, as real pay is still not increasing, productivity shows no sign of rising and the balance of payments remains high by historical standards. Outside of the UK, growth is still erratic in the US and the Eurozone is struggling to grow at all, with the malaise now having spread to the core economies. Doubts remain over the path of the Chinese economy and geopolitical risk within the Middle East and Ukraine has increased significantly over the last year.

Gilt yields (the rate of interest on UK government borrowing) fluctuated in response to events for the first half of the year. In the US, the Federal Reserve held steady its Quantitative Easing stimulus programme, but other events produced downward pressure over the spring and summer. The movement in rates at which local authorities can borrow from the Public Works Loan Board (PWLB) is set out in the table below.

Period	31 March 2014	30 September 2014
1 year	1.3%	1.4%
3 year	2.0%	2.1%
5 year	2.7%	2.6%
10 year	3.6%	3.3%

* These borrowing rates are at the 'Certainty Rate' (0.20% below the PWLB standard rate).

The outlook for the 6-month period ending 31st March 2015 continues to remain muted as nothing is really driving interest rate expectations higher. The lack of inflationary pressure is expected to allow policymakers to hold off monetary tightening for longer than the market currently expects. In particular, longer dated yields are expected to be held down by strong demand.

The Council's treasury advisers, Arlingclose Ltd, do not expect the Bank of England to raise its Base Rate until autumn 2015 and the short term return on cash investments will continue to remain at very low levels.

The focus is now on the rate of increase in the Base Rate and its medium-term peak, with expectations that rates will rise slowly and to a lower level than in the past.

Appendix B

Debt Management Activities from 1st April 2014 to 30th September 2014

	Balance on 01/04/2014 £m	Debt Maturing £m	New Borrowing £m	Balance on 30/09/2014 £m
Capital Financing Requirement (CFR)	**418.2**			
Short Term Borrowing[1]	16.4	0.0	0.0	16.4
Long Term Borrowing	291.6	0.0	0.0	291.6
TOTAL BORROWING	**308.0**	**0.0**	**0.0**	**308.0**
Other Long Term Liabilities	16.8	0.0	0.0	16.8
TOTAL EXTERNAL DEBT	**324.8**	**0.0**	**0.0**	**324.8**

The Council qualifies for borrowing at the 'Certainty Rate' (0.20% below the PWLB standard rate) for a 12-month period from 1st November 2014.

At 30th September 2014, the Council had £324.8m of external borrowing to finance its previous years' capital programmes. With short term interest rates being much lower than long term rates, it continues to be more cost effective in the short term to use internal resources, rather than undertake further long term borrowing. By doing so, the Council is able to minimise net borrowing costs and reduce overall treasury risk. No new external borrowing has been raised so far this year as is shown in the table above.

No debt rescheduling has been undertaken during the financial year as present discount rates make the costs involved unattractive.

Budgeted Expenditure and Outturn

There is a forecast underspend of £0.6m on the Council's £5.9m interest payable expenditure budget for the year. This reflects both interest rates remaining lower than originally estimated and greater than estimated capacity for internal borrowing.

[1] Loans with maturities less than 1 year.

Appendix C

Investment Activities from 1st April 2014 to 30th September 2014

The Council gives priority to security and liquidity and aims is to achieve a yield commensurate with these principles.

	Balance on 01/04/2014 £m	**Investments Made £m**	**Investments Repaid £m**	**Balance on 30/09/2014 £m**
Short Term Investments	20.1	300.8	298.7	22.2
Investments in Pooled Funds	4.9	0.0	0.0	4.9
TOTAL INVESTMENTS	**25.0**	**300.8**	**298.7**	**27.1**

* These figures exclude school balances.

Security of capital has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2014/15. New investments were made with the following classes of institutions:

- A-rated banks and building societies;
- AAA-rated Money Market Funds.

Counterparty credit quality was assessed and monitored with reference to credit ratings (the Council's minimum long-term counterparty rating of A- or equivalent across rating agencies Fitch, Standard & Poors and Moody's), share prices, credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

The average cash balance the Council held was £39.5m over the 6-month period to 30th September 2014, and this will continue to fall over the next two quarters reflecting the seasonal pattern of the income to spend ratio. Currently, the Council has money market deposits placed on varying interest rates ranging between 0.4% and 0.8%.

The Council continues to adhere to its long-standing strategy of holding low cash balances to reduce investment counterparty risk and contain its borrowing costs by utilising cash balances in lieu of borrowing externally.

In March 2014, one of the international credit rating agencies, Moody's, downgraded the long term credit ratings of Royal Bank of Scotland (RBS) and NatWest to Baa1. As this new credit rating fell below the Council's minimum investment credit rating criterion for banks and other financial institutions of A-, the Council's response was to cease making deposits or investments with either RBS or NatWest.

The Council banks with NatWest and will continue to do so for the foreseeable future. Whilst cash balances will be maintained in the NatWest current account, these are kept at a level proportionate to the smooth operation of the Council's payment systems and that which is required for day-to-day liquidity.

Proposed amendment to the Treasury Management Strategy to allow investment in lower rated banks and building societies

The UK is implementing the final bail-in provisions of the EU *Bank Recovery and Resolution Directive* to commence in January 2015, a year ahead of most other countries. Credit rating agencies have stated that they plan to review EU banks' ratings in line with each country's implementation of the directive. Many UK banks have standalone ratings in the 'BBB' category, with uplifts for potential government support taking them into the 'A' category. There is therefore a realistic risk that some major UK bank and building society credit ratings, such as Barclays, Lloyds, Santander UK and Nationwide, will fall below the Council's existing minimum investment credit rating criterion of A- this financial year if this uplift is removed.

A 'BBB' rating denotes investment grade of a good credit quality, where there is a low risk of default and the capacity for payment of financial commitments is considered adequate.

The Council has two broad options to respond to this risk:

- amend the Treasury Management Strategy (TMS) to allow investment in lower rated banks and building societies, or
- prepare to invest without using any of the major UK banks and building societies.

If the Council chooses to respond by changing the TMS, the Council's treasury advisers, Arlingclose Ltd, recommend that an additional criteria of BBB+ should be included in the following Counterparty table of the existing TMS for 2014/15 – see overleaf.

The Council may invest its surplus funds with any of the counterparties in the table below: (Note strategy changes recommended to Council 27th November are indicated by shading below)

Approved Investment Counterparties

Counterparty	
Banks and other organisations and securities whose lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's is:	AAA
	AA+
	AA
	AA-
	A+
	A
	A-
	BBB+
UK Central Government (irrespective of credit rating)	
UK Local Authorities (irrespective of credit rating)	
UK Registered Providers of Social Housing whose lowest published long-term credit rating is A- or higher	
UK Registered Providers of Social Housing whose lowest published long-term credit rating is BBB- or higher and those without credit ratings	
UK Building Societies without credit ratings	
Money market funds and other pooled funds	
Any other organisation, subject to an external credit assessment and specific advice from the treasury management adviser	

The CLG Guidance defines specified investments as those of "high credit quality". Given that Arlingclose Ltd are not advising a lowering of the definition on high credit quality below A-, the Council would also need to increase the cash limit for 'Total investments without credit ratings or rated below A-' for non-specified investments to ensure that there is sufficient headroom. This can be achieved by increasing the current cash limit from £15m to £30m. This change is to allow reasonable investment capacity, if required, to access a number of UK institutions with credit ratings of BBB+.

Non-Specified Investment Limits

	Cash limit
Total long-term investments	£20m
Total investments without credit ratings or rated below A-	£30m
Total investments in foreign countries rated below AA+ by individual country	£10m

Counterparty Investment Limits

To mitigate the potential increase in counterparty risk arising from the above amendments, it is proposed that the cash limit for any single organisation or any group of organisations under the same ownership will be reduced from £15m to £7m as outlined in the following table.

	Cash limit
Any single organisation, except the UK Central Government	£7m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£7m per group
Any group of pooled funds under the same management	£10m per manger
Negotiable instruments held in a broker's nominee account	£10m per broker
Foreign countries	£10m per country
Registered Providers	£10m in total
Building Societies	£10m in total
Loans to small businesses	£10m in total
Money Market Funds	70% in total

Budgeted Income and Outturn

There is a forecast under-recovery of £0.1m on the Council's £0.5m investment interest receivable approved income budget for the year in line with a focus on liquidity as cash balances have reduced to low levels.

Appendix D

Compliance with Prudential Indicators

The Council has complied with its Prudential Indicators from 1st April 2014 to 30th September 2014, set in February 2014 as part of the Council's Treasury Management Strategy Statement.

It should be noted that a counterparty limit was temporarily breached when investment deposits placed with the Lloyds Bank Group, i.e., Lloyds Bank and Bank of Scotland, exceeded the £15m approved group limit for a short period. The breach occurred when a new 32-day notice account was added to the suite of Lloyds Bank Group accounts used by the Council for deposit purposes. However, this new account was not properly incorporated into the spreadsheet used to check the various strategy limits. Consequently, on 7th and 8th May 2014, actual deposits with the Lloyds Bank Group exceeded the limit by £0.5m and by £2.5m between 9th May 2014 and 11th May 2014 (which included a weekend). The position was identified on 12th May 2014 in the course of treasury operations, corrected at the earliest opportunity and reported to the Deputy Leader and Executive Member for Corporate Resources, Chief Executive and Chief Finance Officer. Internal procedures were reviewed and revised to minimise the risk of similar breaches.

Borrowing in Comparison to the Capital Financing Requirement

Estimates of the Council's cumulative maximum external borrowing requirement for 2014/15 to 2016/17 are shown in the table below.

	31/03/2014 Actual £m	**31/03/2015 Estimate £m**	**31/03/2016 Estimate £m**	**31/03/2017 Estimate £m**
Gross CFR	418.2	473.1	506.4	524.7
Less: Other long-term liabilities	(16.8)	(16.3)	(15.7)	(15.3)
Borrowing CFR	**401.4**	**456.8**	**490.7**	**509.4**
Less: Existing profile of borrowing	(308.0)	(291.6)	(282.2)	(275.6)
Gross Borrowing Requirement/Internal Borrowing	**93.4**	**165.2**	**208.5**	**233.8**

These forecast borrowing figures are based on the full capital programme being achieved.

(a) Estimates of Capital Expenditure

This indicator is set to ensure that the level of capital expenditure remains within sustainable limits. The Council's planned capital expenditure and financing, as approved by Council in February 2014, can be summarised as follows.

Capital Expenditure and Financing	**2013/14 Actual £m**	**2014/15 Estimate £m**	**2015/16 Estimate £m**	**2016/17 Estimate £m**
General Fund	74.5	89.6	112.0	73.0
HRA	7.6	17.2	12.1	12.2
Total Expenditure	**82.1**	**106.8**	**124.1**	**85.2**
Capital receipts	(2.9)	(8.2)	(11.9)	(9.5)
Government Grants	(44.6)	(35.7)	(59.5)	(37.5)
Major Repairs Reserve	(6.6)	-	-	-
Revenue contributions	(2.3)	(16.5)	(11.4)	(11.5)
Borrowing	(25.7)	(46.4)	(41.3)	(26.7)
Total Financing	**(82.1)**	**(106.8)**	**(124.1)**	**(85.2)**

(b) Estimates of Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose.

Capital Financing Requirement	**31/03/2014 Actual £m**	**31/03/2015 Estimate £m**	**31/03/2016 Estimate £m**	**31/03/2017 Estimate £m**
General Fund	254.1	308.1	341.4	359.7
HRA	164.1	165.0	165.0	165.0
Total CFR	**418.2**	**473.1**	**506.4**	**524.7**

The CFR is forecast to rise by £106.5m over the next three years as capital expenditure financed by debt outweighs resources put aside for debt repayment.

(c) Gross Debt and the Capital Financing Requirement

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

The Council has had no difficulty meeting this requirement nor are any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

	31/03/2014 Actual £m	31/03/2015 Estimate £m	31/03/2016 Estimate £m	31/03/2017 Estimate £m
CFR	**418.2**	**473.1**	**506.4**	**524.7**
Borrowing	308.0	338.1	370.0	390.0
PFI liabilities	16.8	16.3	15.7	15.3
Gross Debt	**324.8**	**354.4**	**385.7**	**405.3**
Difference	93.4	118.7	120.7	119.4
Borrowed in excess of CFR? (Yes/No)	**No**	**No**	**No**	**No**

(d) Authorised Limit and Operational Boundary for External Debt

The Local Government Act 2003 requires the Council to set an affordable borrowing limit, irrespective of their indebted status, referred to as the Authorised Limit. It is the maximum amount of debt that the Council can legally owe. This is a statutory limit which should not be breached.

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

The Council confirms that there were no breaches to either the Authorised Limit or the Operational Boundary during the first six months of 2014/15, where the maximum extent of external borrowing was £324.8m.

	Authorised Limit for 2014/15 £m	**Operational Boundary for 2014/15 £m**	**Actual External Debt as at 30/09/2014 £m**
Borrowing	493.3	483.3	308.0
Other long-term liabilities	21.8	19.3	16.8
Total	**515.1**	**502.6**	**324.8**

(e) Ratio of Financing Costs to 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 financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	**2013/14 Actual %**	**2014/15 Estimate %**	**2015/16 Estimate %**	**2016/17 Estimate %**
General Fund	6.3	7.2	8.2	9.2
HRA	14.0	13.9	13.6	13.3

(f) Incremental Impact of Capital Investment Decisions:

This is an indicator of affordability that shows the incremental impact of new capital investment decisions included in the current approved capital programme on Council Tax and housing rent levels.

Incremental Impact of Capital Investment Decisions	2014/15 Estimate £	2015/16 Estimate £	2016/17 Estimate £
General Fund – increase in annual band D Council Tax	39.3	41.7	34.6
HRA – increase in average weekly rents	0.3	0.3	0.3

(g) Adoption of the CIPFA Treasury Management Code

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

Adoption of the CIPFA Treasury Management Code
The Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* at its Full Council meeting on 29th November 2012.

(h) Housing Revenue Account (HRA) Debt

The purpose of this limit is to report the level of debt imposed on the Council at the time of the implementation of self-financing by the Department for Communities and Local Government (CLG).

	31/03/2014 Actual £m	31/03/2015 Estimate £m	31/03/2016 Estimate £m	31/03/2017 Estimate £m
HRA Debt Cap (as prescribed by the DCLG)	165.0	165.0	165.0	165.0
HRA CFR	164.1	165.0	165.0	165.0
Difference	**0.9**	**0.0**	**0.0**	**0.0**

(i) Interest Rate Exposures

This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed, are outlined in the table below.

The Council confirms that there were no breaches to either of the upper limits during the first six months of 2014/15, where the proportion of fixed and variable interest rate exposures remained unchanged at 75% and 25% respectively.

	2014/15 %	**2015/16 %**	**2016/17 %**
Upper limit on fixed rate exposure	100	100	100
Actual exposure as at 30/09/2014	**75**		
Upper limit for variable rate exposure	40	40	40
Actual exposure as at 30/09/2014	**25**		

(j) Maturity Structure of Fixed Rate Borrowing

This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing are outlined below.

Maturity Structure of Fixed Rate Borrowing	**Upper Limit %**	**Lower Limit %**	**Actual Fixed Rate Borrowing as at 30/9/2014 £m**	**Fixed Rate Borrowing as at 30/9/2014 %**	**Compliance with Set Limits?**
Under 12 months	20	0	13.5*	5.8	Yes
12 months - 24 months	20	0	0	0.0	Yes
24 months - 5 years	60	0	0	0.0	Yes
5 years - 10 years	100	0	29.8	12.9	Yes
10 years - 20 years	100	0	124.9	54.2	Yes
20 years - 30 years	100	0	0	0	Yes
30 years - 40 years	100	0	40.3	17.5	Yes
40 years - 50 years	100	0	22.1	9.6	Yes
50 years and above	100	0	0	0.0	Yes

* LOBO option dates (on which the lender can require payment) are treated as potential repayment dates

(k) Principal sums invested for periods longer than 364 days

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end are outlined in the table below.

The Council confirms that there was no breach to the £20m limit during the first six months of 2014/15, given that no investments for period longer than 364 days were entered into.

Upper limit for total principal sums invested over 364 days	30/09/2014 Actual £m	2014/15 £m	2015/16 £m	2016/17 £m
	0	20	20	20