APPENDIX A

Treasury Management Strategy Statement and Annual Investment Strategy 2012/13

1. INTRODUCTION/BACKGROUND

1.1. Treasury Management

1.1.1. Treasury Management relates to the policies, strategies and processes associated with managing the short and long term cash and debt of the Council through appropriate borrowing and lending activity.

1.2. Relevant Treasury Management Regulation / Legislation

The Council's treasury management activities are governed by the 2011 CIPFA Code of Practice for Treasury Management in the Public Sector, whose key requirements were adopted by the Council in May 2011 as part of Financial Regulations -Section C. This Code was revised by CIPFA, in 2011, for some minor amendments which have been highlighted in Appendix A.

1.2.1. The Local Government Act 2003, effective from 1st April 2004;

- ~ Requires the Council to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next 3 years to ensure that the Council's capital investment plans (including borrowing plans) are affordable, prudent and sustainable.
- ~ Requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy that sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.
- ~ Gives the Council statutory power to invest for "any purpose relevant to its functions under any enactment, or for the purposes of the prudent management of its financial affairs", including investments made in the course of treasury management.

1.3. Purpose of Report

1.3.1. This report comprises the Treasury Management Strategy Statement for 2012/2013 as Section 2 and the Annual Investment Strategy for 2012/2013 as Section 3 and has been prepared in accordance with the CIPFA Code of Practice for Treasury Management 2011.

1.3.1.1. Treasury Management Strategy Statement 2012/2013

The Treasury Management Strategy Statement is an annual statement that sets out the expected treasury activities for the forthcoming year 2012/2013.

1.3.1.2. The Annual Investment Strategy 2012/2013

The Annual Investment Strategy sets out the Council's policies for investing its surplus cash for the year 2012/2013 and for giving priority to the security and liquidity of its investments over the return on those investments. It forms the basis of the 'Approved Investment Criteria' followed by the Council when making its investments.

1.4. Reporting Arrangements

1.4.1. In accordance with the requirements of the revised Code, this Treasury Management Strategy and Annual Investment Strategy will be presented to the Value for Money Scrutiny Committee for scrutiny and then submitted to the Executive Councillor with responsibility for finance for approval prior to the start of the financial year.

1.4.2. Quarterly reports will then be presented to the Value for Money Scrutiny Committee throughout the financial year which will monitor and report on actual activity against the approved Strategy.

1.4.3. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

2. TREASURY MANAGEMENT STRATEGY STATEMENT 2012/2013

2.1. Introduction

2.1.1. The formulation of the annual Treasury Management Strategy involves determining the appropriate borrowing and investment decisions in light of the anticipated movement in interest rates. The strategy for 2012/2013 is therefore based upon the Treasury officers' current views on interest rates for the year ahead, supplemented with leading market forecasts provided by the Council's treasury management advisor, Sector Ltd. The strategy covers the following areas:

- The current long term external borrowing/investment position;
- Borrowing requirement 2011/2012 to 2014/2015;
- Affordable borrowing limit for 2012/13 to 2014/15;
- Prudential indicators 2012/2013 to 2014/2015
- Prospect for interest rates 2012/2014;
- Long term borrowing strategy 2012/2013;
- Debt rescheduling opportunities;
- Investment strategy 2012/2013;
- Short term (cash flow) borrowing strategy 2012/2013
- Other current treasury issues.

2.2. Current Long Term External Borrowing & Investment Position

2.2.1. In order to place the Treasury Management Strategy in context, the Council's treasury portfolio position at 31.12.2011 comprised:

		Principal £million	Ave Rate %
Long Term Borrowing			
Opening Balance	31.3.11	456.869	4.14
New Borrowing to	31.12.11	0.0	
Borrowing Repaid to	31.12.11	(6.354)	
Rescheduling:			
Borrowing Repaid Early to	31.12.11	0.0	
Borrowing Replaced	31.12.11	0.0	
Total Borrowing at	**31.12.11**	**450.515**	**4.15**
Investments			
LCC at	31.12.11	220.167	
Pension Fund at	31.12.11	7.848	
Total Investments at	**31.12.11**	**228.015**	**1.01**
Net Borrowing at	**31.12.11**	**222.500**	

2.3. Long Term Borrowing Requirement 2011/2012 to 2014/2015

2.3.1. The long term borrowing requirement for 2011/2012 to 2014/2015, as detailed in the Council Budget 2012/13 -2014/15 Report, which is to be considered by the County Council at its meeting on the 17th February 2012, is as follows:

Long Term Borrowing Requirement	**2011/12 £m**	**2012/13 £m**	**2013/14 £m**	**2014/15 £m**	**Total £m**
New Borrowing	55.828	113.239	48.689	59.651	277.407
Replacement Borrowing	5.000	5.000	2.000	10.000	22.000

2.3.2. It is intended that the 2011/12 borrowing requirement will be met by internal resources, not external borrowing, hence lowering actual external borrowing below the Council's Capital Financing Requirement (CFR), a Prudential Indicator, which is a measure of the Council's underlying borrowing need.

2.3.3. This borrowing requirement falls within the Council's 'affordable borrowing limit' as outlined below.

2.4. Affordable Borrowing Limit for 2012/2013 to 2014/2015

2.4.1. The Council has a statutory duty, in accordance with the Local Government Act 2003, to determine and keep under review how much it can afford to borrow i.e. to determine its "Affordable Borrowing Limit".

2.4.2. The Council must have regard to the Prudential Code when setting its Affordable Borrowing 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 levels is acceptable. Both external borrowing and other forms of financing, such as finance leasing and private finance initiative arrangements (PFI) are included within this Affordable Borrowing Limit.

2.4.3. It is also a statutory requirement under Section 33 of the Local Government Finance Act 1992 for the Council to produce a balanced budget. This means that increases in capital expenditure must be limited to a level whereby increased capital finance costs are set to a level that is affordable within the projected income of the Council for the foreseeable future.

2.4.4. The Prudential Indicator for the '<u>Authorised Limit for External Debt</u>', as required by the Prudential Code, is the statutory Affordable Borrowing Limit as determined under the 2003 Act, and this limit must be set on a rolling basis for the forthcoming financial year and two successive financial years. The Council's Authorised Limit For External Debt for 2012/13 to 2014/15 has been set as follows: -

	2012/13 £million	**2013/14 £million**	**2014/15 £million**
Borrowing	634.720	660.154	693.194
Other Long Term Liabilities	24.127	23.124	21.867
TOTAL	**658.847**	**683.278**	**715.061**

2.4.5. The Assistant Director of Resources – Finance & Resources has responsibility to set the Authorised Limit for External Debt, to monitor the external debt level and to report to the Executive Councillor with responsibilities for finance, if he is of the view that the limit is likely to be breached. The Executive Councillor has then to decide to take appropriate action for the limit not to be breached or to raise the limit if prudent to do so.

2.5. <u>Prudential Indicators for 2012/2013 to 2014/2015</u>

2.5.1. Appendix B outlines the Council's Prudential Indicators that are relevant for the purposes of setting an integrated treasury management strategy.

2.5.2. They have been extracted from the comprehensive list of all Prudential Indicators proposed for the Council submitted, as per the requirements of the Prudential Code, with the Council Budget 2012/13 -2014/15 Report, which is to be considered at the meeting of the County Council on 17th February 2012.

2.5.3. Two new Prudential Indicators have been added to this list as a result of the requirements of the 2011 Revision of the CIPFA Code of Practice for Treasury Management and the Prudential Code. These focus of the level of borrowing undertaken in advance of need and are as follows:

'Upper Limit for net debt expressed as a percentage of gross debt'

'Borrowing in advance limited to percentage of expected increase in borrowing need (CFR) over the three year planning period. (Voluntary Indicator)'

2.6. Prospect for Interest Rates 2012-2014

2.6.1. The Council has appointed Sector Treasury Services as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates taking into account the current outlook for the UK Economy. Appendix C draws together a number of current City Institution forecasts for short term and longer fixed interest rates. The following table gives the Sector central view.

Annual Average %	**Bank Rate**	**Money Rates**		**PWLB Borrowing Rates**		
		3 month	**1 year**	**5 year**	**25 year**	**50 year**
Mar 2012	0.50	0.70	1.50	2.30	4.20	4.30
June 2012	0.50	0.70	1.50	2.30	4.20	4.30
Sept 2012	0.50	0.70	1.50	2.30	4.30	4.40
Dec2012	0.50	0.70	1.60	2.40	4.30	4.40
Mar2013	0.50	0.75	1.70	2.50	4.40	4.50
June 2013	0.50	0.80	1.80	2.60	4.50	4.60
Sept 2013	0.75	0.90	1.90	2.70	4.60	4.70
Dec 2013	1.00	1.20	2.20	2.80	4.70	4.80
Mar 2014	1.25	1.40	2.40	2.90	4.80	4.90
June 2014	1.50	1.60	2.60	3.10	4.90	5.00

Economic Commentary

2.6.2. Growth in the UK is expected to be weak in the next two years and there is a risk of a technical recession (i.e. two quarters of negative growth). Bank Rate, currently 0.5%, underpins investment returns and is not expected to start increasing until quarter 3 of 2013, despite inflation currently being well above the Monetary Policy Committee inflation target. Hopes for an export led recovery appear likely to be disappointed due to the Eurozone sovereign debt crisis depressing growth in the UK's biggest export market. The Comprehensive Spending Review, which seeks to reduce the UK's annual fiscal deficit, will also depress growth during the next few years.

2.6.3. Long term fixed interest borrowing rates are based on UK gilt yields. The outlook for borrowing rates is currently much more difficult to predict. The UK total national debt is forecast to continue rising until 2015/16; the consequent increase in gilt issuance is therefore expected to be reflected in an increase in gilt yields over this period. However, gilt yields are currently at historically low levels due to investor concerns over Eurozone sovereign debt and have been subject to exceptionally high levels of volatility as events in the Eurozone debt crisis have evolved.

2.6.4. A more detailed view of the current economic outlook is contained within Appendix D to this report.

2.6.5. This challenging and uncertain economic outlook has several key treasury management implications:

- The Eurozone sovereign debt difficulties, most evident in Greece, provide a clear indication of much higher counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods;

- Investment returns are likely to remain relatively low during 2012/13;

- Borrowing interest rates are currently attractive, but may remain low for some time. The timing of any borrowing will need to be monitored carefully;

- There will remain a cost of capital –i.e., any borrowing undertaken that results in an increase in investments will incur a revenue loss between borrowing costs and investment returns.

2.7. <u>Long Term Borrowing Strategy 2012/2013</u>

2.7.1. In view of the above forecast for interest rates the Council's borrowing strategy will be based upon the following information.

2.7.1.1. Long term rates are difficult to predict for reasons already stated with the likelihood that they will remain flat in 2012/13. Suggested target rates are as follows: 50 yr 4.30%, 25 yr – 4.20%, 10yr – 3.30% and 5 yr – 2.30%.

2.7.1.2. PWLB rates on loans of less than 15 years duration are substantially lower than longer term PWLB rates, giving the opportunity to spread new debt maturities away from a concentration in long dated debt at low rates of interest. The Council's Long Term Borrowing Maturity Profile as at 21st February 2012 can be seen as Appendix E.

2.7.1.3. Market loans and LOBO[1] loans may be available at rates below PWLB rates. However an appropriate balance

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[1] A LOBO is a 'Lender's Option, Borrowers Option' money market loan, whereby the Lender has the option to change the rate of a loan after a designated fixed period of time and the Borrower (LCC) has the option to accept this new rate or repay the loan. The fixed period of

between PWLB and market debt should be maintained in the debt portfolio.

2.7.1.4. Temporary borrowing (up to 1 year) from the money market or other local authorities, at investment level rates, will be an available option.

External V Internal Borrowing

2.7.2. The Council is currently maintaining an ‘under-borrowed’ position, given its decision not to borrow externally in 2011/12. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with external debt, and internal balances and cash flow has been used instead as a temporary measure (referred to as internal borrowing). This strategy is prudent as investment returns are low and counterparty risk is high.

2.7.3. The table below shows the comparison between the Council’s gross and net debt positions at the year end from 2010/11 to 2014/15.

Comparison of gross and net debt at year end	**2010/11 Actual £m**	**2011/12 Probable Outturn £m**	**2012/13 Estimate £m**	**2013/14 Estimate £m**	**2014/15 Estimate £m**
Actual External Debt (Gross)	456.869	450.515	541.353	563.843	598.053
Cash Balances (Investments)	245.645	125.400	129.000	129.000	129.000
Net Debt	211.224	325.115	412.353	434.843	469.053
Net Debt as % of Gross Debt	46.2%	72.2%	76.2%	77.1%	78.4%

2.7.4. The table shows that the difference between gross and net debt is the level of investments held by the Council. It shows that the level of investments has fallen in 2011/12, given the decision to borrow internally in this year, to a level whereby opportunities for further internal borrowing are limited, in order to maintain adequate balances for liquidity/cash flow requirements.

Minimum Revenue Provision / Repayment of Debt

2.7.5. New regulations in 2008 set a duty for the Council to set aside a minimum revenue provision (MRP) for the repayment of debt to the Revenue Account each year which it considers to be prudent. Statutory guidance which accompanies the regulations provides

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time is typically for 1 to 20 years and the total length of the LOBO is typically for 50 to 70 years.

options for calculating MRP. The aim is to ensure that debt is repaid over a period reasonably commensurate with the period over which the capital expenditure funded by borrowing provides benefits.

2.7.6. The Council at its meeting on 13th February 2009 agreed to apply the average life method of calculating MRP for 2009/10 onwards, as supported by the then Resources Policy Development Group and the Council's External Auditors. Full details of the proposal from the Resources PDG 12 January 2009 can be found as Appendix E.

2.7.7. The Council's policy is to repay external debt at the MRP level and as a measure of affordability the following voluntary Prudential Indicator Limit has been set:

'**MRP and Interest as a percentage of the Councils Income will not exceed 10%'.**

<u>Borrowing in Advance of Need</u>

2.7.8. The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds. In determining whether borrowing will be undertaken in advance of need the Council will:

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need.

- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered.

- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow.

- consider the merits and demerits of alternative forms of funding.

- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.

- limit borrowing in advance to no more than 25% of the expected increase in borrowing need (CFR) over the three year planning period. (New Voluntary Prudential Indicator).

2.7.9. Given the factors detailed in 2.7 above, the following borrowing strategy will be adopted for 2012/13:

The Council will take new borrowing from the PWLB in all periods with the aim of achieving an even spread of maturity profile and avoiding an increase in the average cost of the Council's debt. Target levels will be monitored and timing of borrowing taken will coincide with any reduced rate opportunity below the target levels identified.

Consideration will be given to borrowing market loans or LOBOs, to fit into the above maturity strategy, in order to take advantage of the lower rates offered on these loans. This proportion limited to no more than 10% of total external borrowing for each of market loans and LOBOs.

Temporary borrowing from the money markets or other local authorities will be considered if appropriate.

Borrowing in advance of need will be undertaken during the year if considered appropriate following the Council's policy as detailed in 2.7.8 above.

2.7.10. To support the above strategy, prevailing interest rates and market forecasts will be continually monitored throughout the year and appropriate borrowing actions including debt rescheduling, if appropriate, will be taken in response to any sharp rise or fall in long and short term interest rates occurring throughout the year.

2.8. Debt Rescheduling

2.8.1. Debt rescheduling involves repaying existing loans and replacing these with new loans at different terms for the prime objective of generating financial savings on interest paid.

2.8.2. The Council's Financial Strategy states that 'the Council will actively pursue debt rescheduling to the extent that it will generate financial savings without adding significantly to the overall debt burden'.

2.8.3. To date interest savings have been made by rescheduling existing PWLB EIP[2] loans into PWLB maturity[3] loans. At the time

[2] With EIP loans, an equal amount of principal is repaid on a half yearly basis throughout the term of the loan with interest calculated on the reducing balance, hence total payments reduce over the lifetime of the loan.

of writing £24.3 million of EIP debt, from the Council's total debt portfolio of £450.5 million, remains to be rescheduled given the opportunity.

2.8.4. Interest savings may also be achievable in 2012/13 by switching from long term PWLB debt to short term Market Debt or LOBOs, but only in consideration of maintaining an even maturity profile of debt.

2.8.5. Repaying debt early does incur a premium[4] or discount[5] depending on the current level of interest rates compared to the rate of interest on the debt repaid. The timing of any rescheduling during the year will take place to minimise premium or maximise the discount available. This is achieved by repaying loans at a peak in current interest rate levels to reduce the amount of premium due and locking into replacement loans at a trough in current interest rates. This strategy can incur an interest cost due to the delay in replacing debt repaid or interest can be made by borrowing in advance of repaying debt. There is also a level of interest rate risk of any timing decision.

2.8.6. Where possible suitable loans will be selected for rescheduling that match out both premium and discounts, thereby eliminating the cash impact to the Council. Any positions taken via rescheduling will be in accordance with the borrowing strategy position outlined in Section 2.7 above.

2.8.7. The appropriate timing of any rescheduling will be monitored throughout 2012/13 by the Council and Sector Ltd. However, PWLB to PWLB debt restructuring is now much less attractive because of the large premiums that would be incurred due to the introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt and further by the PWLB rate increases included in the 20th October 2010 Comprehensive Spending Review.

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[3] With Maturity loans, only interest repayments are made during the life of the loan and repayment of principal is made in full at the end of the loan period.

[4] A premium is incurred on repaying a loan early when the interest rate of the loan to be repaid is higher than the current rate available for the remaining duration of the existing loan.

[5] A discount is incurred on repaying a loan early when the interest rate of the loan to be repaid is lower than the current rate available for the remaining duration of the existing loan.

2.9. Investment Strategy 2012/2013

2.9.1. Bank Rate is expected to remain unchanged at 0.50% for 2012/13. There is downside risk to this forecast if recovery from the recession proves to be weaker and slower than currently expected.

2.9.2. Given the current concerns over the economic environment, it is prudent to keep investments short (no longer than 3 months) with good quality counterparties, whilst market uncertainty continues.

2.9.3. The Council has average investments of around £200-£250 million net of Pension Fund cash, of which £100-£150 million can be identified as 'core' balances which will be available to invest for longer periods of investment. The remaining balance of cash is cash-flow driven.

2.9.4. The Council's investment priorities are:

(a) the security of capital and
(b) the liquidity of its investments

The Council will aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity and hence has a low risk appetite for placing investments.

2.9.5. Given these factors above, the following investment strategy will be adopted for 2012/13:

Investments will be made in all periods of 3 months to 1 year, to acceptable counterparties, to lock into rates in excess of the predicted base rate level where possible throughout the year for some element of the Council's investment portfolio that represents 'core' balances. However, during the period of market uncertainty, investments will be restricted to no more than 3 months to all counterparties other than part-nationalised UK Banks. The Council will avoid locking into longer term deals (beyond 1 year) while investment rates are down at historically low levels unless exceptionally attractive rates are available which make longer term deals worthwhile. Extensive use of Bank Business Reserve Accounts and Money Market Funds[6] will be made, that offer returns in excess of base rate level, for the Council's 'core' cash and cash flow generated balances. The target investment return for investments for 2012/13 is the weighted 7 day/3 month LIBID benchmark adopted that reflects the risk parameters of the investment portfolio. This is a relative

[6] Pooled investment vehicles offering returns equivalent of up to 1 month cash deposits whose assets comprise of cash type investments such as Certificates of Deposit, Commercial Paper and Cash Deposits.

benchmark which moves with the markets, but as an indication the benchmark rate at 31st December 2011 was 0.66%.

Short term investment in Certificates of Deposit[7] and Treasury Bills[8] will also be considered where appropriate.

Short dated deposits (overnight to 1 month) will also be made for the Council's cash-flow generated balances in order to benefit from compounding of interest.

2.9.6. In addition to the above strategy, prevailing interest rates and market forecasts will be continually monitored throughout the year and appropriate investment actions will be taken in response to any sharp rise or fall in long and short-term interest rates occurring throughout the year.

2.9.7. All Investments will be made in accordance with the Council's Annual Investment Strategy, as outlined in Section 3 of this report and with the institutions identified in the Council's approved counterparty investment list.

2.9.8. At the time of writing, the Council has no outstanding investments over 1 year in duration.

2.10. <u>Short Term (Cash Flow) Borrowing Strategy 2012/2013</u>

2.10.1. During 2012/2013, when short term interest rates for temporary borrowing are significantly lower than yields earned on the Council's Call Accounts and Money Market Funds, then if required for cash flow purposes, temporary short term borrowing will be taken instead of drawing on investments, in order to minimise the loss of interest from withdrawing funds at higher rates.

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[7] A bearer instrument which certifies that a sum of money has been deposited with the bank issuing the certificate at a fixed yield and on the stated maturity date the deposit is repaid with interest. The maturity length is typically from 1 month to 1 year.

[8] Short term securities issued by HM Treasury on a discounted basis i.e. issued below 100, with 100 being received on maturity with the difference equalling the interest return.

2.11. Other Current Treasury Issues

2.11.1. Long Term Borrowing – School Loans Scheme 2012/13

Long Term Borrowing from the PWLB on behalf of schools as part of the schools loan scheme will be undertaken throughout 2012/2013 as and when required and on terms requested by schools.

2.11.2. Leasing Requirements – School IT and General Equipment

It is anticipated that up to £500,000 of School IT and general equipment may be leased in 2012/2013 as part of an agreed strategy for acquiring use of such equipment by schools. Three and five year finance leases will be arranged on behalf of the schools as required.

2.11.3. Policy on the Use of External Service Providers

The Council uses Sector Treasury Services 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.

2.11.4. Pension Fund Cash

In line with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 which were implemented on 1st January 2010, effective from 1st April 2010, an agreement has been drawn up governing the procedures that were already in place for the pooling of Pension Fund cash with Council balances for investment.

3. ANNUAL INVESTMENT STRATEGY 2012/2013

3.1. In accordance with Section 15(1) of the Local Government Act 2003, Lincolnshire County Council has adhered to the Guidance on Local Government Investments issued by the Secretary of State, and as such has produced its Annual Investment Strategy for 2012/2013 detailed below.

3.2. The Council's investment priorities will be security first, liquidity second, and then return. The intention of the Strategy is to provide security of investment and minimisation of risk. The aim of the Strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk. Investment instruments identified for use in 2012/2013 under Specified and Non-Specified investment categories are detailed below.

3.3. Specified Investments

3.3.1. In accordance with CLG Guidance on Local Government Investments, this Council will invest its surplus funds throughout the year in the following specified investments, which it regards as offering high security and high liquidity.

- Investments made in sterling, which mature within and including 12 months (such investments to include fixed, callable or forward term deposits as appropriate[9], Certificates of Deposit and Treasury Bills), with the following categories: -

  - UK Government
  - Local Authorities
  - Body or Investment Scheme meeting the required level of credit quality as determined by credit rating agencies.*

*Lincolnshire County Council has determined this required level of credit quality to be as follows: -

[9] Fixed Deposit : Investment fixed for specific term at specific rate.
Callable Deposit : Investment whereby borrower has option to pay back deposit at specific intervals.
Forward Deposit : Investment whereby period, rate and amount are agreed in advance of a future date. The forward period plus the deal period to be within the maturity limit allowed.

Body or Investment Scheme	Sector Weighted Credit Colour Band	Minimum Acceptable Credit Rating **
Bank or Building Society	**Blue (Nationalised / Semi Nationalised UK Banks only**	**Long Term Rating (Fitch): AA-**
	Orange	
	Red	**Sovereign Rating (Fitch): AAA**
	Green	
Money Market Funds		**Long Term Rating (Moodys): Aaa/MR1+ or (Fitch): AAA or (S & P): AAAm**

**For definition of credit ratings see Appendix G.

This Council uses the creditworthiness service provided by Sector, its treasury management advisor. This service has been progressively enhanced and now uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:

- Credit watches and credit outlooks from credit rating agencies –see Appendix G for definition.
- Credit default swap (CDS) spreads to give early warning of likely changes in credit ratings – see Appendix G for definition.

This modelling approach combines credit ratings, credit watches, credit outlooks and CDS spreads in a weighted scoring system for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. Rating Agency information and CDS spreads are monitored on a real time basis with knowledge of any changes sent electronically by Sector as soon as they are detected. The Council is satisfied that this service gives an improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.

Additional Minimum Rating Criteria/Limits in Place –set by Council

In addition to the Sector creditworthiness service, the Council has also retained an additional minimum Long Term Rating from Fitch of –AA and a minimum Sovereign (Country) Rating from Fitch of AAA. (For definitions of these ratings please refer to Appendix G). This restricts the number of acceptable counterparties further and is deemed prudent. In the event that global financial events undermine the current AAA minimum Sovereign Rating policy , then the policy will be reviewed at this time, with a view to making any changes to the policy within one month. A further limit of a maximum of no more than 20% of total investments to be placed with any one bank/group or building society sector is also in place to ensure diversification of investments.

Duration and Limits

From the above methodology the following duration and amount limits have been assigned to each colour band as follows:

Sector Weighted Colour Band	**Maximum Duration**	**Maximum Amount**
Blue***	1 Year	£40m
Orange	1 Year	£20m
Red	6 Months	£15m
Green	3 Months	£10m

*** *Applies to nationalised or semi nationalised UK Banks*:-

As a result of the banking crisis which started in 2008, Governments across the world have had to inject capital directly into banks to support their capital ratios and to avoid failure of financial institutions. Several banks have been nationalised or part nationalised in this way.

These nationalised banks in the UK have credit ratings which do not conform to the credit criteria usually used by Councils to identify banks which are of high credit worthiness. As they are no longer separate institutions in their own right, their individual ratings, which assess their stand alone financial strength, are impaired. However, it is considered that institutions that have been nationalised or part nationalised effectively take on the creditworthiness of the Government itself and as such UK nationalised or semi nationalised banks are included within the Councils acceptable investment criteria and will continue to do so as long as they remain semi nationalised.

3.3.2. The Assistant Director of Resources –Finance & Resources has delegated responsibility to produce an ‘Approved Lending List’ of acceptable counterparties to whom the Council will lend its surplus cash which comply with the specified investments detailed above and the non-specified investments detailed below. The credit ratings of counterparties are monitored on an ongoing basis. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

- If a downgrade results in the counterparty/investment scheme no longer meeting the Council’s minimum criteria, its further use as a new investment will be withdrawn immediately.

- In addition to the use of Credit Ratings, the Council will be advised of information in movements in CDS prices of Counterparties against the iTraxx benchmark[10] and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or suspension from the Council's lending list.

3.3.3. Sole reliance will not be placed on the use of this external service. In addition, this Council will also use market data and market information, information on government support for banks and the credit ratings of that government support.

3.4. <u>Non-Specified Investments</u>

3.4.1. In accordance with CLG Guidance on Local Government Investments, non-specified investments are those that do not meet the definition of specified investments as detailed above, and they are viewed as being higher risk.

3.4.2. Having assessed the acceptable level of risk involved in all non-specified investments, it is the decision of the Assistant Director of Resources- Finance & Resources to allow the prudent investment in the following non-specified investments:

- Sterling investments for a maturity period greater than 12 months up to a maximum of 2 years, (such investments to include fixed, callable or forward deposits as appropriate).

3.4.3. The above non-specified investments may be made to any category as detailed in the specified investments above, with the exception of Bodies or Investment Schemes that will be restricted to the following level of credit worthiness criteria:

Body or Investment Scheme	**Sector Weighted Credit Colour Band**	**Minimum Acceptable Credit Rating ****
Bank or Building Society	Purple	Long Term Rating (Fitch): AA-
		Sovereign Rating (Fitch): AAA

** For definition of credit ratings see Appendix G

[10] iTraxx Senior Financials Index that measures the "average" level of the most liquid financial CDS prices in the CDS market.

The following duration and amount limits have been assigned to this colour band as follows:

Sector Weighted Colour Band	Maximum Duration	Maximum Amount
Purple	2 Years	£25m

3.4.4. In line with the Prudential Code Indicator, the maximum amount of investment that can be held in investments over 12 months at any one time is £40 million. This limit reflects a prudent proportion of the Council's estimated level of core cash balances available to invest for longer periods.

3.4.5. The Executive Councillor with responsibility for finance will be informed on any occasion when investments are lent for over 12 months.

3.5. Additions to Non-Specified Investment List

3.5.1. Proposals to invest in any other non-specified investment will be referred to the Assistant Director of Resources for approval after first seeking the advice of the Authority's Treasury advisors, Sector Ltd. If approved by the Assistant Director of Resources – Finance & Resources, a recommendation for the change to the Annual Investment Strategy will be sought from the Executive Councillor with responsibility for finance.

3.6. Liquidity of Investments

3.6.1. In determining the amount of funds that can prudently be committed for more than 12 months, consideration will be given to the following factors:

- Long Term Cash Flow Forecasts of the Council - 3 years ahead showing:
  - Projected core cash balances over the term of proposed investment
  - Foreseeable spending needs over the term of proposed investment.
  - Level of provision for contingencies.
  - Acceptable level of reserves.

3.7. <u>Training Needs for Treasury Management Staff</u>

3.7.1. The importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them are recognised by the Council. Consequently, the Council seeks to appoint individuals who are both capable and suitably experienced and also will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills.

3.7.2. <u>Approved Training Courses</u>: All treasury management staff are encouraged to take the CIPFA/ACT qualification in 'International Treasury Management (Public Finance)'. Both the Treasury Manager and Treasury Officer for the Council have successfully gained this qualification.

3.7.3. On-going treasury management training is available for staff from various sources such as the Council's Treasury Management advisors, CIPFA, Money Brokers, other treasury trainers and in-house, where identified as appropriate.

ANNEX A

The Revised CIPFA Treasury Management Code of Practice 2011 – Key Areas

The revised Code has four main revisions, ignoring Housing Revenue Account changes, as follows:-

a) The Code does suggest the use of financial derivative instruments, such as SWAPS, for use in interest rate risk management and has included several references to these instruments throughout different areas of the Code to cover those authorities who wish to use them. However CIPFA has provided no opinion as to the legality of using these instruments and it is recommended that legal support be obtained prior to such use.
b) The Treasury Policy Statement now requires high-level policies for borrowing and investments – although no guidance is provided.
c) There is a new treasury indicator on gross and net debt to manage borrowing in advance of need.
d) The maturity profile prudential indicator has changed the definition for maturity of a LOBO type loan.

Other than the above, changes are largely regulatory updates.

ANNEX B

PRUDENTIAL INDICATORS:	2011/12	2012/13	2013/14	2014/15
Affordability:				
Increase in council tax levels	£16.47	£15.48	£27.98	£3.23
Ratio of Net Financing Costs to Net Revenue Stream	4.58%	5.08%	5.70%	5.59%
Ratio of MRP & Interest Payments to Net Revenue Stream -10% limit (Voluntary Indicator)	4.60%	5.03%	5.72%	5.83%
Capital Expenditure:	**£m**	**£m**	**£m**	**£m**
Capital Financing Requirement CFR (as at 31 March)	518.965	609.055	629.407	661.245
TREASURY INDICATORS (within the Prudential Code):				
Authorised limit for external debt -				
Borrowing	559.880	634.720	660.154	693.194
Other long term liabilities	23.739	24.127	23.124	21.867
TOTAL	583.619	658.847	683.278	715.061
Operational boundary -				
Borrowing	535.880	610.720	636.154	669.194
Other long term liabilities	21.739	22.127	21.124	19.867
TOTAL	557.619	632.847	657.278	689.061
TREASURY INDICATORS (with the TM Code):				
Gross and Net Debt				
Upper limit for net debt as a percentage of gross debt	100%	100%	100%	100%
Borrowing in advance of need limited to percentage of the expected increase in CFR over the 3 year budget period. (Voluntary Indicator)	25%	25%	25%	25%
Upper limit for fixed interest rate exposure	**£m**	**£m**	**£m**	**£m**
Net principal re fixed rate borrowing less investments	661.245	661.245	661.245	661.245
Upper limit for variable rate exposure	**£m**	**£m**	**£m**	**£m**
Net principal re variable rate borrowing less investments	198.374	198.374	198.374	198.374
	£m	**£m**	**£m**	**£m**
Upper limit for total principal sums invested for over 364 days (per maturity date)	40.000	40.000	40.000	40.000

Maturity structure of new fixed rate borrowing during 2012/13	upper limit	lower limit
under 12 months	25%	0%
12 months and within 24 months	25%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and above	100%	0%

Interest Rate Forecast 2011/2015

Sector's Interest Rate View															
	Now	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Sector's Bank Rate View	**0.50%**	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	2.00%	2.25%	2.50%
3 Month LIBID	**0.87%**	0.70%	0.70%	0.70%	0.70%	0.70%	0.75%	0.80%	0.90%	1.20%	1.40%	1.60%	2.10%	2.40%	2.60%
6 Month LIBID	**1.16%**	1.00%	1.00%	1.00%	1.00%	1.00%	1.10%	1.20%	1.40%	1.60%	1.80%	2.00%	2.50%	2.70%	2.90%
12 Month LIBID	**1.65%**	1.50%	1.50%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.20%	2.40%	2.60%	3.10%	3.20%	3.30%
5yr PWLB Rate	**2.25%**	2.30%	2.30%	2.30%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.10%	3.30%	3.50%	3.70%
10yr PWLB Rate	**3.33%**	3.30%	3.30%	3.30%	3.40%	3.40%	3.50%	3.60%	3.70%	3.80%	4.00%	4.20%	4.40%	4.60%	4.80%
25yr PWLB Rate	**4.24%**	4.20%	4.20%	4.20%	4.30%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%
50yr PWLB Rate	**4.26%**	4.30%	4.30%	4.30%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.30%
Bank Rate															
Sector's View	**0.50%**	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	2.00%	2.25%	2.50%
UBS	**0.50%**	0.50%	0.50%	0.50%	0.50%	0.50%	-	-	-	-	-	-	-	-	-
Capital Economics	**0.50%**	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	-	-	-	-	-
5yr PWLB Rate															
Sector's View	**2.25%**	2.30%	2.30%	2.30%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.10%	3.30%	3.50%	3.70%
UBS	**2.25%**	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital Economics	**2.25%**	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	-	-	-	-	-
10yr PWLB Rate															
Sector's View	**3.33%**	3.30%	3.30%	3.30%	3.40%	3.40%	3.50%	3.60%	3.70%	3.80%	4.00%	4.20%	4.40%	4.60%	4.80%
UBS	**3.33%**	3.45%	3.45%	3.50%	3.60%	3.65%	-	-	-	-	-	-	-	-	-
Capital Economics	**3.33%**	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	-	-	-	-	-
25yr PWLB Rate															
Sector's View	**4.24%**	4.20%	4.20%	4.20%	4.30%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%
UBS	**4.24%**	4.80%	4.90%	4.90%	4.90%	4.90%	-	-	-	-	-	-	-	-	-
Capital Economics	**4.24%**	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	-	-	-	-	-
50yr PWLB Rate															
Sector's View	**4.26%**	4.30%	4.30%	4.30%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.30%
UBS	**4.26%**	4.80%	4.95%	4.95%	5.00%	5.00%	-	-	-	-	-	-	-	-	-
Capital Economics	**4.26%**	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	-	-	-	-	-

ANNEX D

Economic Background –Source Sector Treasury Services Ltd

1. Global economy

The outlook for the global economy remains clouded with uncertainty with the UK economy struggling to generate sustained recovery that offers any optimistim for the outlooks for 2011 and 2012, or possibly even into 2013. Consumer and business confidence levels are low and with little to boost sentiment, it is not easy to see potential for a significant increase in the growth rate in the short term.

At the centre of much of the uncertainty is the ongoing **Eurozone sovereign debt crisis** which has intensified, rather than dissipated throughout 2011. The main problem has been **Greece**, where, even with an Eurozone/IMF/ECB bailout package and the imposition of austerity measures aimed at deficit reduction, the lack of progress and the ongoing deficiency in addressing the underlying lack of competitiveness of the Greek economy, has seen an escalation of their problems. These look certain to result in a default of some kind but it currently remains unresolved if this will be either “orderly” or “disorderly”, and/or also include exit from the €uro bloc.

As if that were not enough there is growing concern about the situation in **Italy** and the risk that contagion has not been contained. Italy is the third biggest debtor country in the world but its prospects are limited given the poor rate of economic growth over the last decade and the lack of political will to address the need for fundamental reforms in the economy. The Eurozone now has a well established track record of always doing too little too late to deal with this crisis; this augurs poorly for future prospects, especially given the rising level of electoral opposition in northern EU countries to bailing out profligate southern countries.

The US economy offers little to lift spirits. With the next Presidential elections due in November 2012, the current administration has been hamstrung by political gridlock with the two houses split between the main parties. In quarter 3 the Federal Reserve started “Operation Twist” in an effort to re-ignite the economy in which growth is stalling. High levels of consumer indebtedness, unemployment and a moribund housing market are weighing heavily on consumer confidence and so on the abiltity to generate sustained economic growth.

Hopes for broad based recovery have, therefore, focussed on the **emerging markets** but these areas have been struggling with inflationary pressures in their previously fast growth economies. China, though, has maintained its growth pattern, despite tightening monetary policy to suppress inflationary pressures, but some forward looking indicators are causing concern that there may not be a soft landing ahead, which would then be a further dampener on world economic growth.

2. UK economy

The Government’s austerity measures, aimed at getting the public sector deficit into order over the next four years, have yet to fully impact on the economy. However, coming at a time when economic growth has virtually flatlined and concerns at the risk of a technical recession (two quarters of negatibe growth) in 2012, it looks likely that the private sector will not make up for the negative impact of these austerity measures given the lack of an export led recovery due to the downturn in our major trading partner – the EU. The housing market, a gauge of consumer confidence, remains weak and the outlook is for house prices to be little changed for a prolonged period.

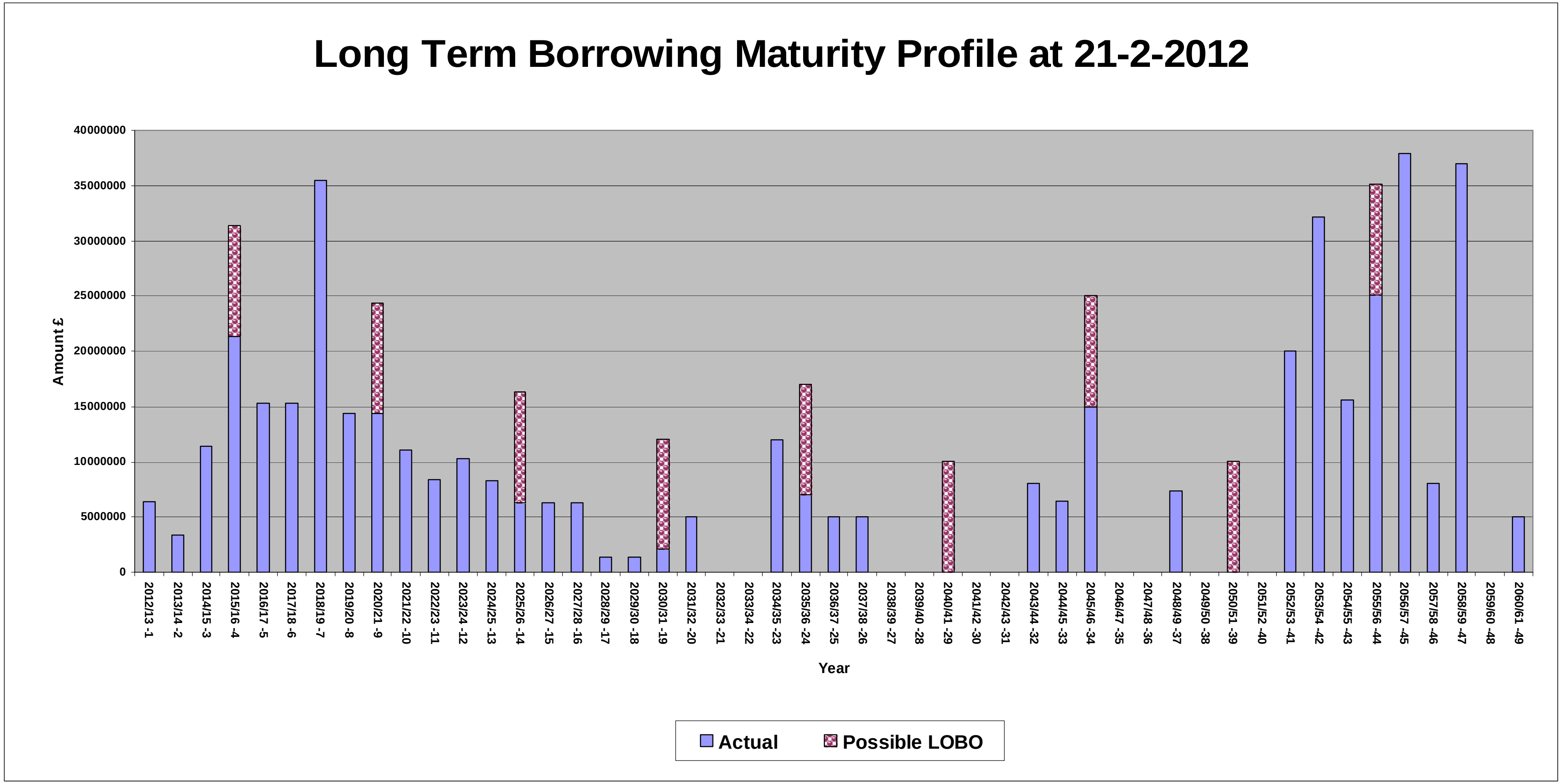
Economic Growth. GDP growth has, basically, flatlined since the election of 2010 and, worryingly, the economic forcecasts for 2011 and 2012 have been revised lower on a near quarterly basis as the UK recovery has, effectively, stalled. With fears of a potential return to recession the Bank of England embarked on a second round of Quantitive Easing to stimulate economic activity.

Unemployment. With the impact of the Government's austerity strategy impacting the trend for 2011 of steadily increasing unemployment, there are limited prospects for any improvement in 2012 given the deterioration of growth prospects.

Inflation and Bank Rate. For the last two years, the MPC's contention has been that high inflation was the outcome of temporary external factors and other one offs (e.g. changes in VAT); that view remains in place with CPI inflation standing at 5.2% at the start of quarter 4 2011. They remain of the view that the rate will fall back to, or below, the 2% target level within the two year horizon.

AAA rating. The ratings agencies have recently reaffirmed the UK's AAA sovereign rating and have expressed satisfaction with Government policy at deficit reduction. They have, though, warned that this could be reviewed if the policy were to change, or was seen to be failing to achieve its desired outcome. This credit position has ensured that the UK government is able to fund itself at historically low levels and with the safe haven status from Eurozone debt also drawing in external investment the pressure on rates has been down, and looks set to remain so for some time.

ANNEX E



Long Term Borrowing Maturity Profile at 21-2-2012
Amount £
40000000
35000000
30000000
25000000
20000000
15000000
10000000
5000000
0
Year
2012/13 -1
2013/14 -2
2014/15 -3
2015/16 -4
2016/17 -5
2017/18 -6
2018/19 -7
2019/20 -8
2020/21 -9
2021/22 -10
2022/23 -11
2023/24 -12
2024/25 -13
2025/26 -14
2026/27 -15
2027/28 -16
2028/29 -17
2029/30 -18
2030/31 -19
2031/32 -20
2032/33 -21
2033/34 -22
2034/35 -23
2035/36 -24
2036/37 -25
2037/38 -26
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2045/46 -34
2046/47 -35
2047/48 -36
2048/49 -37
2049/50 -38
2050/51 -39
2051/52 -40
2052/53 -41
2053/54 -42
2054/55 -43
2055/56 -44
2056/57 -45
2057/58 -46
2058/59 -47
2059/60 -48
2060/61 -49
Actual
Possible LOBO

ANNEX F

Resources Policy Development Group
12 January 2009

MINIMUM REVENUE PROVISION

Report by the Director of Resources

Introduction

1. The Council, at its meeting on 27 June 2008, resolved that the Council's policy for minimum revenue provision (MRP) for 2009/10 be developed in consultation with the Resources PDG and with the Council's external auditor and proposed to the Council in February 2009.

2. This report proposes a policy for minimum revenue provision for the PDG's consideration. The Council's external auditor is also being consulted. The policy will need to be considered by the Executive and by the Council in February. In future, the Council is required to approve a policy for MRP each year.

Background

3. Most councils borrow to fund capital spending. They are required to set aside some of their revenues each year as a provision for debt repayment. The requirement has been that a minimum provision should be calculated as 4% of a council's capital financing requirement – essentially its total debt outstanding.

4. New regulations set a duty for a council to set a minimum revenue provision which " it considers prudent."

Statutory guidance which accompanies the regulations provides options for calculating MRP. The aim is to ensure that debt is repaid over a period reasonably commensurate with the period over which the capital expenditure funded by borrowing provides benefits.

The Council must select and apply one of these options.

MRP options

5. The regulations distinguish between "supported" and "unsupported" borrowing in relation to the options. "Supported" borrowing is borrowing which, theoretically, attracts government support for debt repayment through revenue support grant. "Unsupported" borrowing is funded wholly by individual councils.

The options are described below.

Capital financing requirement method

- MRP is calculated as 4% of the Council's capital financing requirement.
- This method can be applied only to "supported" borrowing.

Depreciation method

- MRP is based on depreciation of the assets acquired
- But may cease to be charged when the total provision made equals the amount borrowed.
- Either the depreciation method or the average life method must be applied to "unsupported" borrowing.

Average life method

- MRP is made in equal instalments over the estimated life of the assets acquired through borrowing.

6. It is proposed to adopt the average life method for the reasons set out below.

The capital financing requirement method can be applied only to "supported" borrowing. It would therefore need to be combined with one of the other methods for "unsupported" borrowing. The Council uses both "supported" and "unsupported" borrowing and the distinction between the two types has no relevance for the Council. It would be simpler to apply one calculation method for the whole of the Council's borrowing.

7. The depreciation method, whilst theoretically attractive, introduces some complications. For example, assets must be valued in the Council's balance sheet at current value and the valuations are updated regularly. MRP provision would change as assets are revalued. Depreciation is not normally applied to land. However, some provision for the repayment of borrowing for the acquisition of land would be necessary. Therefore the depreciation method would need to be combined with the asset life method for land acquisition. It would also be necessary to keep individual accounting records for each item of capital expenditure which would be a substantial additional workload.

8. The average life method is simpler than the depreciation method and is the only method that can be applied to the whole of the Council's borrowing. It provides a stable and predictable MRP provision which will assist the Council's budgeting. It is a prudent approach with annual provision for the repayment of debt related directly and clearly to the useful life of the assets acquired through borrowing.

Asset lives

9. The proposed method requires estimates to be made for asset lives. The table below proposes the bases for estimation.

Type of asset	Estimated asset life in years
New capital spending :	
Land	50
Buildings	40
Roads	40
Capital maintenance - buildings	20
Capital maintenance – roads	20
Integrated transport	20
Equipment and vehicles	4
Previous capital spending	25

Impact on the Council's spending

10. The MRP must be charged as part of the Council's revenue spending each year. It may therefore impact on the Council's finances.

The existing provision in the Council's budget is based on a MRP of 4% equivalent to charges made over 25 years.

11. The new annual MRP charges resulting from the proposed policy are likely to be close to this. The average life of assets in the 2007/08 and 2008/09 capital programmes is 24.7 years and 27.2 years respectively It is also proposed to base MRP on an average asset life of 25 years for past capital spending.

The MRP should therefore be met within existing budget proposals.

12. It should also be noted that the MRP is a minimum provision. The Council may, if it wishes, make additional repayments.

Recommendation

The Policy Development Group is asked to support the proposal to adopt the average life method for calculating minimum revenue provision.

ANNEX G

<u>Definition of Credit Ratings and Credit Default Swap Spreads</u>

<u>Credit Ratings:</u>

<u>Long Term Rating (Fitch)</u>

The Long Term rating assesses the borrowing characteristics of banks and the capacity for the timely repayment of debt obligations which apply to instruments of up to 5 years duration.

Long Term Ratings range from AAA, AA, A to DDD, DD, D. Only Institutions with Ratings of AA- and above are acceptable on the Councils Lending List as follows:

AAA - Highest Credit Quality - lowest expectation of credit risk. Exceptionally strong capacity for timely payment of financial commitments. Highly unlikely to be adversely affected by foreseeable events.

AA - Very High Credit Quality - Very low expectation of credit risk. Very strong capacity for timely payment of financial commitments. Not significantly vulnerable to foreseeable events.

"+" Or "-" may be appended to a rating to denote relative status within major rating categories.

<u>Sovereign Ratings (Fitch)</u>

The Sovereign (Governments of Countries) Rating measures a sovereign's capacity and willingness to honour its existing and future obligations in full or on time. It looks at factors such as:

- Macroeconomic performance and prospects;
- Structural features of the economy that render it more or less vulnerable to shocks as well as political risk and governance factors;
- Public finances, including the structure and sustainability of public debt as well as fiscal financing;
- The soundness of the financial sector and banking system, in particular with respect to macroeconomic stability and contingent liability for the sovereign; and
- External finances, with a particular focus on the sustainability of international trade balances, current account funding and capital flows, as well as the level and structure of external debt (public and private).

Sovereign Ratings range from AAA, AA, A to DDD, DD, D. Only countries with a Sovereign Rating AAA are acceptable on the Councils Lending List.

Credit Rating Watches and Outlooks issued by Credit Rating Agencies

Rating Watches -indicate that there is a heightened probability of a rating change in the short term either in a positive or negative direction. A Rating Watch is typically event-driven and, as such, it is generally resolved over a relatively short period.

Rating Outlooks -indicate the direction a rating is likely to move over a one- to two-year period reflecting a position not yet reached but if trends continue will do so hence triggering a rating move.

Money Market Fund Rating (Moodys)

Aaa/MR1+ - this rating denotes the lowest expectation of default risk. It is assigned only in cases of exceptionally strong capacity for payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events. Funds rated MR1+ are considered to have the lowest market risk.

Credit Default Swap (CDS) Spreads

A CDS is effectively a contract between two counterparties to 'insure' against default. The higher the CDS price of a counterparty, the higher the supposed risk of default. The CDS level therefore provides a perceived current market sentiment regarding the credit quality of acounterparty and generally the movement in the CDS market gives an early warning of the likely changes in credit ratings of a counterparty.

Sector has employed a benchmark system which compares the CDS spread of a counterparty against a pre-determined benchmark rate (iTraxx Senior Financial Index) to produce a CDS status overlay of 'In Range', 'Monitoring' or 'Out of Range' and this status is used to further determine the creditworthiness of the counterparty.