Inverclyde
council

AGENDA ITEM NO. 4

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| **Report To:** | **Policy & Resources Committee** | **Date:** | **13 August 2013** |
| **Report By:** | **Chief Financial Officer** | **Report No:** | **FIN/53/13/AP/KJ** |
| **Contact Officer:** | **Alan Puckrin** | **Contact No:** | **01475 712223** |
| **Subject:** | **TREASURY MANAGEMENT – ANNUAL REPORT 2012/13** | | |

## 1.0 PURPOSE

1.1 The purpose of this report is to advise members of the operation of the treasury function and its activities for 2012/13 as required under the terms of Treasury Management Practice 6 ("TMP6") on "Reporting Requirements and Management Information Arrangements".

## 2.0 SUMMARY

2.1 As at 31 March 2013 the Council had debt (excluding PPP) of £224,411,117 and investments of £67,314,005. This compares to debt (excluding PPP) of £194,640,228 and investments of £59,204,345 at 31 March 2012.

2.2 The average rate of return achieved on investments during 2012/13 was 2.18% which exceeds the benchmark return rate for the year of 0.56% by 1.62% and resulting in £1,278,200 of additional interest on investments for the Council.

2.3 During 2012/13 the Council did not undertake any debt restructuring and operated within the required treasury limits and Prudential Indicators for the year set out in the Council's Treasury Policy Statement, annual Treasury Strategy Statement, and the Treasury Management Practices. The exceptions to this related to exceeding the investment limits with the Council's bankers on a number of occasions, all of which were reported to Committee during 2012/13.

2.4 From 2013/14 onwards the Council is required to compare its Gross External Debt (which was £298.215m for 2012/13 including PPP) to its Capital Financing Requirement (£296.719m for 2012/13). The Gross External Debt at 31 March 2013 was £1.496m (0.5%) over the Capital Financing Requirement due to the Council borrowing earlier in 2012/13 to fund its estimated capital expenditure in year but some of that estimated expenditure having later been rephased to 2013/14. The Gross External Debt is projected to be under the Capital Financing Requirement for 2013/14 onwards.

## 3.0 RECOMMENDATIONS

3.1 It is recommended that the Committee notes the contents of the annual report on Treasury Management for 2012/13 and the ongoing work to ensure the delivery of financial benefits for the Council.

3.2 It is also recommended that the Annual Report be remitted to the Full Council for approval.

Alan Puckrin
Chief Financial Officer

## 4.0 BACKGROUND

4.1 The Council is required by regulations issued under the Local Government in Scotland Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2012/13.

Annual Report for 2012/13

4.2 Treasury Management in this context is defined as: “The management of the local authority’s cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”

This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

4.3 This annual treasury report covers:

- the Council’s treasury position as at 31st March 2013;
- performance measurement;
- the strategy for 2012/13;
- the wider economy and interest rates in 2012/13;
- the borrowing outturn for 2012/13;
- debt rescheduling;
- compliance with treasury limits and Prudential Indicators in 2012/13;
- investment strategy and outturn for 2012/13;
- other issues.

Treasury Management is a complex area with its own terminology and acronyms. In order to aid the Committee’s understanding a Glossary of Terms is attached as Appendix 1.

4.4 Treasury Position As At 31st March 2013

The Council’s debt and investment position was as follows:

| | 31st March 2013 | | 31st March 2012 | |
|---|---|---|---|---|
| | Principal | Rate | Principal | Rate |
| | £000 | | £000 | |
| Fixed Rate Funding: | | | | |
| - PWLB | 121,468 | | 91,697 | |
| - Market * | 56,000 | | 51,000 | |
| | 177,468 | 3.97% | 142,697 | 4.29% |
| Variable Rate Funding: | | | | |
| - PWLB | 0 | | 0 | |
| - Market * | 46,900 | | 51,900 | |
| - Temporary | 43 | | 43 | |
| | 46,943 | 5.04% | 51,943 | 4.79% |
| **Total Debt** | **224,411** | **4.19%** | **194,640** | **4.43%** |

* - Market Loans are shown as variable when they have less than 1 year to go until their next call date. The total value of Market Loans has not changed between 2011/12 and 2012/13, just the split between fixed and variable.

| | 31st March 2013 | | 31st March 2012 | |
|---|---|---|---|---|
| | Principal | Return | Principal | Return |
| | £000 | | £000 | |
| Investments: | | | | |
| - External | 57,500 | 2.51% | 53,000 | 2.18% |
| - Deposit Accounts | 9,814 | 0.58% | 6,204 | 0.62% |
| **Total Investments** | **67,314** | **2.23%** | **59,204** | **2.02%** |

4.5 Performance Measurement

One of the key changes in a previous revision of the Code was the formal introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide.

An alternative measure is the Council's Loans Fund Pool Rate for Interest which is used to allocate interest charges to the General Fund and reflects the actual cost of the Council's Treasury activities. The rates for the last 5 years are as follows:

| Year | Loans Fund Pool Rate |
|---|---|
| 2008/09 | 4.608% |
| 2009/10 | 3.805% |
| 2010/11 | 4.300% |
| 2011/12 | 4.208% |
| 2012/13 | 3.811% |

4.6 Strategy For 2012/13

The Council's borrowing strategy for 2012/13 was based on the following information:

- The Bank Rate was expected to increase in Quarter 3 to 0.75% and then in Quarter 4 of 2012 to 1.00%.
- PWLB rates were expected to increase during the year by around 0.20% with PWLB rates on shorter period loans expected to be significantly lower than longer term PWLB rates.
- The difference between short term and longer term borrowing rates was expected to give significant opportunities to generate savings by switching from long term debt to short term debt. These savings were, however, to be considered in the light of their short term nature and the likely cost of refinancing those short term loans, once they matured, compared to the current rates of longer term debt in the Council's debt portfolio.

The strategy was to take account of the following suggested order of priority for borrowing:

- The cheapest borrowing was expected to be internal borrowing by running down cash balances and foregoing interest earned at historically low rates. However, in view of the overall forecast for borrowing rates to increase over the next few years, consideration was also to be given to weighing the short term advantage of internal borrowing against potential long term costs if the opportunity was missed for taking loans at rates which will be higher in future years.
- Temporary borrowing from the money markets or other local authorities.
- PWLB variable rate loans for up to 10 years.
- Short dated borrowing from non-PWLB sources.
- Long/

- Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) whilst seeking to maintain an appropriate balance between PWLB and market debt in the debt portfolio.
- PWLB borrowing for shorter periods where rates were expected to be significantly lower than rates for longer periods. This offered a range of options for new borrowing which would spread debt maturities away from a concentration in longer dated debt.

On the use of External Borrowing against using Internal Borrowing:

- The general aim of the treasury management strategy was to seek to reduce and then approximately maintain the difference between the Gross and Net debt levels over the following three years in order to reduce the credit risk incurred by holding investments whilst meeting liquidity requirements and retaining flexibility over funding requirements.
- It was expected that 2012/13 would see continued abnormally low Bank Rates, providing a continuation of the window of opportunity for local authorities to fundamentally review their strategy of undertaking new external borrowing.
- One factor which will be carefully considered is the difference between borrowing rates and investment rates to ensure the Council obtains value for money once an appropriate level of risk management has been attained to ensure the security of its investments.

Against this background, and with regard to the level of Council investments, caution was to be adopted with the 2012/13 treasury operations. The Chief Financial Officer was to monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to the Policy & Resources Committee.

4.7 <u>The Wider Economy and Interest Rates In 2012/13</u>

<u>Sovereign debt crisis</u>
The EU sovereign debt crisis was an ongoing saga during the year. However, the European Central Bank statement in July 2012 that it would do “whatever it takes” to support struggling Eurozone countries provided a major boost in confidence that the Eurozone was beginning to get on top of its problems. This was followed by the establishment of the Outright Monetary Transactions Scheme in September. During the summer, a €100bn package of support was given to Spanish banks. The crisis over Greece blew up again as it became apparent that the first bailout package was insufficient. An eventual and very protracted agreement of a second bailout for Greece in December was then followed by a second major crisis, this time over Cyprus, towards the end of the year. In addition, the Italian general election in February resulted in an anti-austerity party gaining a 25% blocking vote with the potential for problems if the grand coalition formed in April proves unable to agree on individual policies. This could then cause a second general election – but one which could yield an equally ‘unsatisfactory’ result. There are continuing concerns that this approach has merely postponed the ultimate debt crisis, rather than provide a conclusive solution. These problems will, in turn, also affect the financial strength of many already weakened European Union banks during the expected economic downturn in the European Union. There are also major questions as to whether the Greek Government will be able to deliver on its promises of cuts in expenditure and increasing tax collection rates, given the hostility of much of the population.

<u>UK</u>
The UK coalition Government maintained its tight fiscal policy stance against a background of warnings from two credit rating agencies that the UK could lose its AAA credit rating. Moody’s followed up this warning by downgrading the rating to AA+ in February 2013 and Fitch then placed their rating on negative watch, after the Budget statement in March, and downgraded the rating to AA+ in April 2013. Key to retaining

the AAA rating from Standard & Poor's will be a return to strong economic growth in order to reduce the national debt burden to a sustainable level, within a reasonable timeframe.

UK growth

2012/13 started the first quarter with negative growth of -0.4%. This was followed by an Olympics-boosted +0.9% in the next quarter, then by a return to negative growth of -0.3% in the third quarter and finally a positive figure of +0.3% in the last quarter. This weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing (QE) by £50bn in July to a total of £375bn on concerns of a downturn in growth and a forecast for inflation to fall below the 2% target. QE was targeted at further gilt purchases. In the March 2013 Budget, the Office for Budget Responsibility yet again slashed its previously over-optimistic growth forecasts, for both calendar years 2013 and 2014, to 0.6% and 1.8% respectively.

Inflation

UK CPI inflation has remained stubbornly high and above the 2% target, starting the year at 3.0% and still being at 2.8% in March; however, it is forecast to fall to 2% in three years time. The MPC has continued its stance of looking through temporary spikes in inflation by placing more importance on the need to promote economic growth.

Gilts

Gilt yields oscillated during the year as events in the ongoing Eurozone debt crisis ebbed and flowed, causing corresponding fluctuations in safe haven flows into / out of UK gilts. This, together with a further £50bn of QE in July and widely expected further QE still to come, combined to keep PWLB rates depressed for much of the year at historically low levels.

Interest Rates

Bank Rate was unchanged at 0.50% throughout the year, while expectations of when the first increase would occur were pushed back to quarter 1 of 2015 at the earliest.

The Funding for Lending Scheme, announced in July, resulted in a flood of cheap credit being made available to banks and this has resulted in money market investment rates falling sharply in the second half of the year. However, perceptions of counterparty risk have improved after the ECB statement in July that it would do "whatever it takes" to support struggling Eurozone countries. This has resulted in some return of confidence to move away from only very short term investing.

PWLB "Certainty Rate"

The documents from the March 2012 Budget included a proposal for a 0.20% reduction in PWLB rates for local authorities "providing improved information and transparency on their locally-determined long-term borrowing and associated capital spending plans." Further details of the proposed "certainty rate" only became available from HM Treasury in August 2012 with the rate applying to new borrowing from 1 November 2012 for authorities who provided additional information on 3-year planned capital expenditure and borrowing before 17 September 2012.

The Council has not yet taken any borrowing which has taken advantage of the Certainty Rate. As explained below, the Council undertook borrowing during 2012/13 but at a time when PWLB rates were at low levels and projected to increase and when no information had been issued by HM Treasury or the PWLB about how and when the Certainty Rate would be implemented.

4.8 Borrowing Outturn For 2012/13
The Council undertook the following borrowing during the year:

April 2012
- £5,000,000 at 0.50% for 3 months

May 2012
- £10,000,000 at 2.88% for 9½ years

July 2012
- £5,000,000 at 2.31% for 8 years
- £7,500,000 at 2.69% for 10½ years
- £7,500,000 at 2.79% for 11½ years.

The March 2012 Budget had limited information on the proposed Certainty Rate so it was unclear how and when the proposed rate would be implemented. Given this uncertainty and the Council's need for borrowing for its capital expenditure, the borrowing in April 2012 as shown above was on a temporary basis so that a decision on borrowing could be taken later if more information was forthcoming on the Certainty Rate.

The May 2012 borrowing was undertaken given the Council's funding requirements and the likelihood of increases in PWLB rates, even given the proposed Certainty Rate. The July 2012 borrowing was done for the same reasons and to repay the temporary borrowing undertaken in April 2012.

4.9 Debt Rescheduling

Rescheduling Strategy – The Council's treasury consultants started 2012/13 with the expectation that PWLB rates were expected to rise but that rates were more difficult to predict given that the rates are based on volatile UK gilt yields. Short term borrowing rates were expected to be considerably cheaper than longer term rates with significant opportunities to generate savings by switching from long term debt to short term debt. Moving from long term to short term debt would, however, mean taking on a greater risk exposure to having to re-borrow longer term in later years at considerably higher rates.

Rescheduling Outturn For 2012/13 – The Council undertook no debt restructuring in 2012/13.

4.10 Compliance With Treasury Limits and Prudential Indicators in 2012/13
During the financial year the Council operated within the required treasury limits and Prudential Indicators for 2012/13 set out in the Council's Treasury Policy Statement, annual Treasury Strategy Statement, and the Treasury Management Practices other than on a few occasions as reported to Committee in August 2012 and November 2012. The Prudential and Treasury Indicators and Council policy limits monitored during the year are shown in Appendix 2 and in Appendix 3.

As Appendix 2 shows, the Council is currently required to compare its Net External Debt (£230.901m for 2012/13 being Gross Debt less Investments) to its Capital Financing Requirement (£296.719m for 2012/13) and the Council have complied with this indicator. The indicator is changing from 2013/14 onwards to compare Gross External Debt (£298.215m for 2012/13) to the Capital Financing Requirement. The Gross External Debt was £1.496m (0.5%) over the Capital Financing Requirement at 31 March 2013 which is due to the Council having borrowed in 2012/13 to fund its estimated capital expenditure in year but some of that estimated expenditure was later rephased to 2013/14 (as advised in reports on the Capital Programme). As the Treasury Management Strategy Statement agreed by the Council on 11 April 2013 shows, the Gross External Debt is projected to be under the Capital Financing Requirement for 2013/14 onwards.

4.11 Investment Strategy and Outturn for 2012/13

Investment Policy – The Council's investment policy is governed by Scottish Government Investment Regulations, which was implemented in the annual investment strategy approved by the Council on 12 April 2012. This policy sets out the approach for choosing investment categories and counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

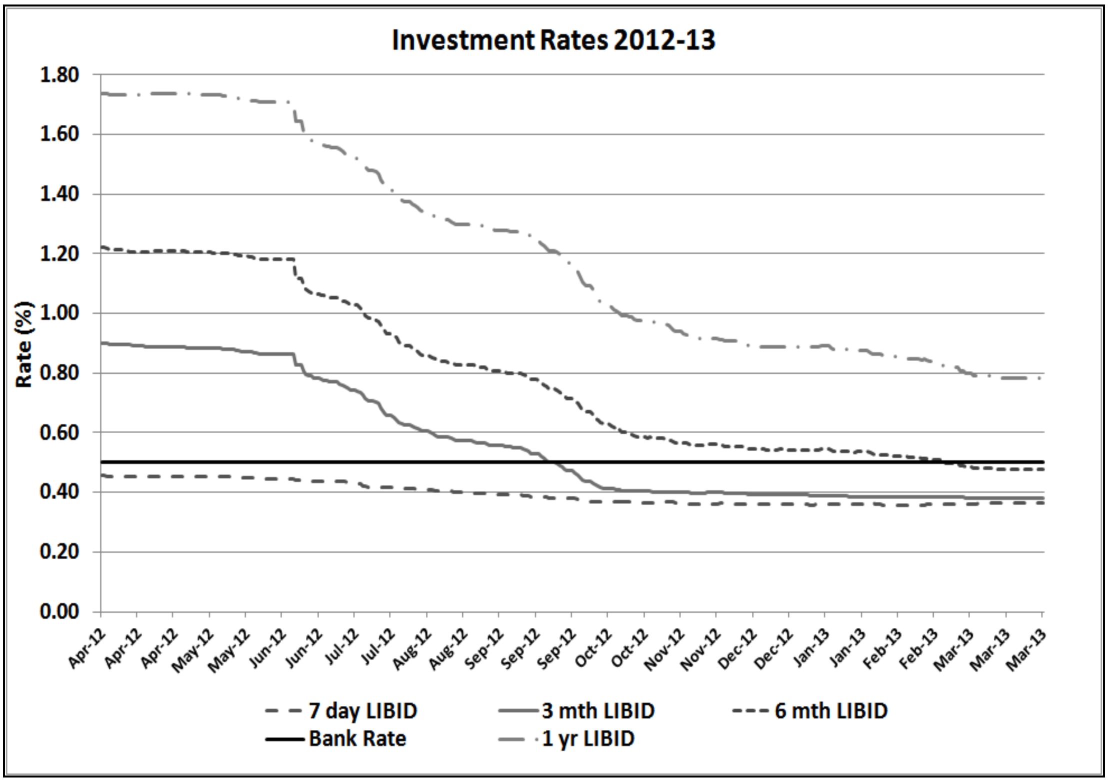
Investment Strategy – The Bank Rate had been unchanged at 0.50% since March 2009. It was forecast to commence rising in Quarter 3 of 2013 and then to rise gently from thereon. Bank Rate forecasts for financial year ends (March) were as follows (compared to the latest position):

| | Forecast Per 2012/13 Strategy | Actual/Latest Forecast | |
|---|---|---|---|
| 2012/13 | 0.50% | 0.50% | (Actual) |
| 2013/14 | 1.25% | 0.50% | (Forecast) |
| 2014/15 | 2.50% | 0.75% | (Forecast) |

The forecast increases in interest rates may well be delayed if the recovery from the recession proves to be weaker and slower than expected.

Investment Rates and Outturn for 2012/13 –The Bank Rate remained at its historic low of 0.50% throughout the year, the same level it has been at since March 2009. Market expectations of the start of monetary tightening (i.e. increases in the Bank Rate) were pushed back during the year to early 2015 at the earliest.

Deposit rates fell sharply during the year, largely due to the Funding for Lending Scheme.




The Council's investment policy is governed by Scottish Government investment regulations which have been implemented in the annual investment strategy approved by the Council on 12 April 2012. The policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, etc.).

All investments were in accordance with the policy and no institutions with which investments were made had any difficulty in repaying investments and interest in full during the year.

The result of the investment strategy undertaken by the Council in 2012/13 is as follows:

| Average Investment | Rate of Return (gross of fees) | Benchmark Return (3 month LIBID uncompounded) |
|---|---|---|
| £78,900,000 | 2.18% | 0.56% |

The Council have outperformed the benchmark by 1.62% resulting in additional income to the Council of £1,278,200.

This performance is due to the Council undertaking fixed term investments at interest rates that were well above the benchmark with a counterparty which has high creditworthiness (the Bank of Scotland) and in accordance with the Council's investment strategy.

The fall in Deposit Rates during the year means that the Council will not achieve similar performance against the benchmark in future.

## 5.0 IMPLICATIONS

5.1 Legal: None. Any borrowing or lending is done under the Council's legal powers.

Finance: Through the achievement of exceeding the investment benchmark return rate, the Council has benefited from additional returns of £1,278,200. The Council utilises Treasury Management as part of the overall Financial Strategy and Officers will continue to investigate borrowing and investment opportunities to bring financial benefits to the Council, all within the Treasury Management Policy.

Human Resources: None.

Equalities: None.

## 6.0 CONSULTATIONS

6.1 This report has been produced based on advice from the Council's treasury advisers (Sector Treasury Services Limited).

## 7.0 LIST OF BACKGROUND PAPERS

7.1 CIPFA - Treasury Management in the Public Services – Code of Practice and Cross-Sectoral Guidance Notes – 2011 Edition
Inverclyde Council – Treasury Management Strategy 2012/13.

# TREASURY MANAGEMENT
# GLOSSARY OF TERMS

Affordable Capital Expenditure Limit
The amount that the Council can afford to allocate to capital expenditure in accordance with the requirements of the Local Government in Scotland Act 2003 and supporting regulations.

Authorised Limit for External Debt
This is a limit for total Council external debt as set by the Council based on debt levels and plans.

Bank of England
The central bank for the UK with ultimate responsibility for setting interest rates (which it does through the Monetary Policy Committee or “MPC”).

Bank Rate
The interest rate for the UK as set each month by the Monetary Policy Committee (“MPC”) of the Bank of England. This was previously referred to as the “Base Rate”.

Capital Expenditure
Expenditure on or for the creation of fixed assets that meets the definition of Capital Expenditure under the accounting rules as set-out in the Code of Practice on Local Authority Accounting in the United Kingdom and for which the Council are able to borrow.

Capital Financing Requirement
The Capital Financing Requirement (sometimes referred to as the “CFR”) is a Prudential Indicator that can be derived from the information in the Council’s Balance Sheet. It generally represents the underlying need to borrow for capital expenditure.

CDS Spread
A CDS Spread or “Credit Default Swap” Spread is the cost of insuring against default by a Counterparty. Increases in the CDS Spread for a Counterparty may indicate concerns within the market regarding a Counterparty.

Certificates of Deposit
Certificates of Deposit (or CDs) are a form of investment and similar to Fixed Term Deposits in that the investment is with a named Bank or Financial Institution, matures on a set date, and is repaid with interest on the maturity date. Unlike a Fixed Term Deposit, a CD can also be traded in the market prior to maturity.

CIPFA
CIPFA is the Chartered Institute of Public Finance and Accountancy who produce guidance, codes of practice, and policy documents for Councils.

Consumer Prices Index
The Consumer Prices Index (“CPI”) is a means of measuring inflation (as is the Retail Prices Index or “RPI”). The Monetary Policy Committee of the Bank of England set the Bank Rate in order to try to keep CPI at or close to the target set by the Government (currently the target is 2%). The calculation of the CPI includes many items of normal household expenditure but the calculation excludes some items such as mortgage interest payments and Council Tax.

Counterparty
Another organisation involved in a deal i.e. if the Council enters a deal with a bank then the bank would be referred to as the “Counterparty”.

Credit Ratings
Credit ratings are indicators produced by a ratings provider (such as Fitch, Moody's or Standard & Poor's) that aim to give an opinion on the relative ability of a financial institution to meet its financial commitments. Credit ratings are not guarantees – they are opinions based on investigations and assessments by the ratings providers and they are regularly reviewed and updated. The Council makes use of credit ratings to determine which counterparties are appropriate or suitable for the Council to make deposits with.

The highest credit rating is AAA.

European Central Bank
Sometimes referred to as “the ECB”, the European Central Bank is the central bank for the Eurozone and is the equivalent of the Bank of England. The European Central Bank sets interest rates for the Eurozone.

Eurozone
This is the name given to the countries in Europe that have the Euro as their currency. Interest rates in the Eurozone are set by the European Central Bank. The Eurozone is comprised of the following 17 countries: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, and Spain.

Fed Rate
This is the interest rate for the US. Rates for the US are set by the Federal Reserve (the central bank for the US and the equivalent of the Bank of England).

Federal Reserve
Sometimes referred to as “the Fed”, the Federal Reserve is the central bank for the US and is the equivalent of the Bank of England. The Federal Reserve sets interest rates for the US.

Fixed Rate Funding/Investments
This term refers to funding or investments where the interest rate that applies to payments or receipts of interest on the funding or investments is fixed and does not change.

Fixed Term Deposit
A Fixed Term Deposit or Fixed Term Investment is an investment with a named Bank or Financial Institution which matures on a set date and which is repaid with interest on the maturity date. Fixed Term Deposits cannot be traded and cannot be terminated before the maturity date without the payment of a penalty (if at all).

Flat Yield Curve
A flat yield curve occurs where the yield for long-term investments is the same or similar to the yield for short-term investments – the period of the investment makes no or little difference to the yield on the investment.

G7/G8/G20
These are forums for discussions by the governments of large world economies.

The G7 is comprised of Canada, France, Germany, Italy, Japan, the UK, and the USA. The G8 is the G7 plus Russia (with the European Union also attending). The G20 is comprised of 19 countries (including the G7 and Russia) plus the European Union.

Gilt Yields
A gilt yield is the effective rate of return that someone buying a gilt at the current market price will receive on that gilt. Since the market price of a gilt can vary at any time, the yield will also vary.

Gilts
Gilts are bonds (i.e. debt certificates) that are issued (i.e. sold) by the UK Government. When they issue gilts the Government sets the interest rate that applies to the gilt, sets when they will repay the value of the gilt, and it agrees to make interest payments at regular intervals until the gilt is repaid or redeemed. Gilts are traded in the financial markets with the price varying depending on the interest rate applicable to the gilt, when the gilt will be repaid (i.e. when it will mature), on Bank Rate expectations, and on market conditions.

Gross Domestic Product
Gross Domestic Product ("GDP") is a measure of the output of goods and services from an economy.

Growth
Positive growth in an economy is an increase in the amount of the goods and services produced by that economy over time. Negative growth is a reduction in the amount of the goods and services produced by that economy over time.

IMF
The International Monetary Fund oversees the world financial system and seeks to stabilise international exchange rates, facilitate development, and provide resources to countries in balance of payments difficulties or to assist with poverty reduction.

Incremental Impact of Capital Investment Decisions
These are Prudential Indicators that reflect the impact on Council Tax of movements in projected and estimated capital expenditure within and between financial years.

Inflation
Inflation is the term used for an increase in prices over time. It can be measured in various ways including using the Consumer Prices Index ("CPI") or the Retail Prices Index ("RPI").

Inverted Yield Curve
An inverted or negative yield curve shows long-term investments having lower yields than short-term investments (an investor gets a better yield by investing for a shorter period).

Investment Regulations
The Local Government in Scotland Act 2003 allows the Scottish Ministers to introduce Regulations to extend and govern the rules under which Scottish Councils may invest funds. The Local Government Investments (Scotland) Regulations 2010 came into effect on 1 April 2010.

LIBID
This is the London Interbank Bid Rate – an interest rate that is used between banks when they wish to attract deposits from each other.

LIBOR
This is the London Inter Bank Offering Rate – an interest rate that is used as a base for setting interest rates for deals between banks.

LOBO
This is a form of loan that the Council has with some lenders. The term is short for the phrase "Lender Option/Borrower Option".

Money Market Fund
A Money Market Fund (or MMF) is a highly regulated investment product into which funds can be invested. An MMF offers the highest possible credit rating (AAA) whilst offering instant access and the diversification of risk (due to the MMF's balances being investing in selected and regulated types of investment product with a range of different and appropriately credit-rated counterparties).

MPC
The MPC or Monetary Policy Committee is a committee of the Bank of England that meets each month (in a meeting over 2 days) to set the Bank Rate for the UK.

Negative Yield Curve
A negative or inverted yield curve shows long-term investments having lower yields than short-term investments (an investor gets a better yield by investing for a shorter period).

Net Borrowing Requirement
This is the difference between the Council's net external borrowing and its capital financing requirement. Under the Prudential Code the Council's net external borrowing should not, except in the short term, exceed its capital financing requirement. The Net Borrowing Requirement should therefore normally be a negative figure.

Operational Boundary
This is a level of debt set by the Council at lower than the Authorised Limit and which Council debt levels should not normally exceed during normal operations.

Positive Yield Curve
A positive yield curve shows long-term investments having higher yields than short-term investments (an investor gets a higher rate yield for investing for longer).

Prudential Code
Councils are required to comply with the CIPFA Prudential Code for Capital Finance in Local Authorities. These requirements include the production of Prudential Indicators. The Prudential Code was last revised in November 2011.

Prudential Indicators
Indicators set-out in the Prudential Code that will help Councils to meet requirements in relation to borrowing limits or which will help Councils demonstrate affordability and prudence with regard to their prudential capital expenditure.

PWLB
The Public Works Loan Board is a government agency and part of the Debt Management Office. The PWLB provides loans to local authorities and other specified bodies.

PWLB Certainty Rates
In the Budget in March 2012, the Chancellor of the Exchequer announced that local authorities that provide information on their long-term borrowing and capital spending plans would be eligible for a 0.20% discount rate for new PWLB borrowing. This PWLB Certainty Rates came into effect on 1 November 2012.

PWLB Rates
These are the interest rates chargeable by the Public Works Loan Board for loans. The rates for fixed rate loans are determined by the day on which the loan is agreed. The rates to be charged by the PWLB for loans are set each day based on gilt yields at the start of business each day and then updated at least once during the day.

Quantitative Easing
This is the creation of money by a central bank (such as the Bank of England) in order to purchase assets from banks and companies and boost the supply of money in an economy.

Ratings
Ratings are indicators produced by a ratings provider (such as Fitch, Moody's or Standard & Poor's) that aim to give an indication of the financial or operational strength of entities including financial institutions and even countries. Ratings are not guarantees – they are opinions based on investigations and assessments by the ratings providers and they are regularly reviewed and updated. The Council makes use of credit ratings to determine which counterparties are appropriate or suitable for the Council to make deposits with.

Repo Rate
This is another name for the Bank Rate as set by the Monetary Policy Committee.

Retail Prices Index
The Retail Prices Index ("RPI") is a means of measuring inflation (as is the Consumer Prices Index or "CPI"). The calculation of the RPI includes most of the same items as the CPI as well as some items not included in the CPI such as mortgage interest payments and Council Tax whilst excluding items that are in the CPI such as charges for financial services.

Sector
Sector Treasury Services Limited who are the Council's treasury management advisers.

Sovereign Debt
The public/national debt owed by a country or countries.

Treasury Management Code
This is the "Treasury Management in the Public Services: Code of Practice" and is a code of practice for Council treasury management activities. It is produced by CIPFA and was last revised in November 2011.

Treasury Management Indicators
These are Prudential Indicators specifically relating to Treasury Management issues.

Treasury Management Practices (TMPs)
This is a Council document that sets out Council policies and procedures for treasury management as required by the Treasury Management Code. The Council also agrees an annual treasury management strategy that is submitted to Committee in accordance with the Treasury Management Practices.

Variable Rate Funding/Investments
Funding or investments where the interest rate that applies to payments or receipts of interest on the funding or investments varies on an agreed basis.

Yield
The yield is the effective rate of return on an investment.

Yield Curve
A graph showing the yield on investments plotted against the maturity period for investments:

- A positive yield curve shows long-term investments having higher yields than short-term investments (an investor gets a higher rate yield for investing for longer).
- A negative or inverted yield curve shows long-term investments having lower yields than short-term investments (an investor gets a better yield by investing for a shorter period).
- A flat yield curve occurs where the yield for long-term investments is the same or similar to the yield for short-term investments – the period of the investment makes no or little difference to the yield on the investment.

Finance Services
Inverclyde Council
July 2013.

**Appendix 2**

## PRUDENTIAL/TREASURY INDICATORS AND COUNCIL POLICY LIMITS

| | Estimate For 2012/13 | Actual For 2012/13 To 31/3/2013 | Within Limits | |
|---|---|---|---|---|
| | £million | £million | | |
| PI 7 - Authorised Limit for External Debt (Excl PPP) | 246.787 | 224.411 | Yes | |
| PI 8 - Operational Limit for External Debt (Excl PPP) | 240.057 | 224.411 | Yes | |
| PI 10 - Compliance with CIPFA code | | | Yes | |
| | % | % | | Comment |
| PI 11 - Upper limit on fixed interest rate exposure | 150.000% | 112.967% | Yes | See Note |
| PI 12 - Upper limit on variable interest rate exposure | 40.000% | -12.967% | Yes | See Note |
| | | | | |
| PI 13 Borrowing fixed rate maturing in each period (LOBOs included based on call dates rather than maturity dates) | Upper | Lower | Actual As At 31/3/2013 | Within Limits |
| Under 12 months | 40% | 0% | 0.000% | Yes |
| 1 - 2 years | 40% | 0% | 2.423% | Yes |
| 2 - 5 years | 40% | 0% | 27.054% | Yes |
| 5 - 10 years | 40% | 0% | 34.443% | Yes |
| 10 - 30 years | 40% | 0% | 9.596% | Yes |
| 30 - 50 years | 40% | 0% | 26.484% | Yes |
| 50 years and above | 40% | 0% | 0.000% | Yes |
| TOTAL | | | 100.000% | |
| | | | | |
| | Limit For 2012/13 £ | Maximum In Period £ | Within Limit | Comment |
| PI 14 - Upper limit on sums invested for periods longer than 364 days | 10,000,000 | 0 | Yes | --- |
| | | | | |
| | CFR At 31/3/2013 | Net/Gross External Debt At 31/3/2013 | Net/Gross External Debt Below CFR? | |
| | £million | £million | | |
| Net External Debt Compared To Capital Financing Requirement (CFR) | 296.719 | 230.901 | Yes | Indicator Required For 2012/13 |
| Gross External Debt Compared To Capital Financing Requirement | 296.719 | 298.215 | NO | Indicator Required From 2013/14 |
| | | | | |
| **Council Policy Limits** | | | | |
| | Limit per Council Policy | Actual As At 31/3/2013 | Within Limits | |
| Maximum proportion of borrowing at variable interest rates | 40% | 20.918% | Yes | |
| Maximum proportion of debt restructuring in any one year | 30% | 0.000% | Yes | |
| Maximum proportion of debt repayable in any one year | 25% | 17.824% | Yes | |

Note

The value for PI 12 (Upper Limit on Variable Interest Rate Exposure) is negative whilst the value for PI 11 (Upper Limit on Fixed Interest Rate Exposure) is above 100%. This is due to the indicators being calculated by taking the Council's borrowing less the Council's investments for each type of interest rate taken as a percentage of the Council's total net borrowing. The reason for the unusual indicator figures is that the Council's investments and deposit accounts are at variable interest rates.

**Appendix 3**

**PRUDENTIAL INDICATORS**

| | 2011/12 | 2012/13 |
|---|---|---|
| | **Actual** | **Actual** |
| **Capital Expenditure (Indicator 5)** | £000 | £000 |
| Non - HRA # | 84,860 | 48,391 |
| HRA ## | 0 | 0 |
| TOTAL | 84,860 | 48,391 |
| | | |
| **Ratio of financing costs to net revenue stream (Indicator 1)** | | |
| Non – HRA | 10.81% | 10.93% |
| HRA ## | 0.00% | 0.00% |
| | | |
| **Net borrowing requirement (Indicator 4)** | £000 | £000 |
| As At 31 March | -57,092 | -61,942 |
| | | |
| **Capital Financing Requirement as at 31 March (Indicator 6)** | £000 | £000 |
| Non - HRA # | 271,948 | 296,719 |
| HRA ## | 0 | 0 |
| TOTAL | 271,948 | 296,719 |
| | | |
| | £000 | £000 |
| **Upper limit for total principal sums invested for over 364 days (Indicator 14)** | 0 | 0 |

# - The Indicator includes PPP schools, as required by the accounting rules. The Indicator for 2011/12 is significantly higher than that for 2012/13 due to PPP secondary schools becoming operational during 2011/12.
## - The Council undertook Housing Stock Transfer during 2007/08.