

**Manchester City Council  
Report for Resolution**

**Report To:** Resource and Governance Overview and Scrutiny Committee – 4 February 2010

**Subject:** Treasury Management Strategy Statement & Borrowing Limits and Annual Investment Strategy 2010-11

**Report of:** City Treasurer

---

**Summary**

To set out the proposed Treasury Management Strategy Statement and Borrowing Limits for 2010-11 and Prudential Indicators for 2010-11 to 2012-13.

**Recommendations**

To note the proposed Treasury Management Strategy Statement :-

- The Treasury Indicators listed in Appendix A of this report.
- The MRP Strategy outlined in Appendix B.
- The revised Treasury Management Policy Statement at Appendix C
- The revised Treasury Management Code of Practice at Appendix D
- The Borrowing Requirements listed in section 4.
- The Borrowing Strategy outlined in section 6.
- The Annual Investment Strategy detailed in section 7.

Subject to the comments of the Committee the Treasury Management Strategy as contained in this report will be sent to Executive for approval on 10 February as part of the budget report.

---

**Wards Affected:**

Not Applicable

---

**Contact Officers:**

Richard Paver	Tel. 0161 234 3564	r.paver@manchester.gov.uk
Carol Culley	Tel. 0161 234 3406	c.culley@manchester.gov.uk
Samantha Mcardle	Tel. 0161 234 3459	s.mcardle@manchester.gov.uk

**Background documents (available for public inspection):**

Reports by Sector Treasury Services (Treasury Advisors)  
and Financial records held in room 102.

Accounting

## 1.0 Introduction

The Council's Treasury Management policy complies with the CIPFA Code of Practice on Treasury Management. This was adopted by the Council on 8 October 2003. In accordance with best practice, the City Treasurer has undertaken a review of the policy and is satisfied that the clauses contained therein are still relevant and complete.

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

The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act) (included as section 10); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The proposed strategy for 2010/11 is based upon the views of Treasury officers on interest rates, informed by leading market forecasts. The report covers the following:

- Treasury limits in force;
- Prudential Indicators;
- The current treasury position of the Council;
- Borrowing Requirement;
- Interest rate prospects;
- Capital borrowings and the portfolio strategy;
- MRP Strategy;
- Investment strategy.

A glossary of terminology used in this report is attached in Appendix 1

## 1.1 The Revised CIPFA Treasury Management Code of Practice 2009

In the light of the Icelandic situation in 2008, CIPFA has amended the CIPFA Treasury Management in the Public Services Code of Practice (the Code), Cross-Sectoral Guidance Notes and Guidance Notes and the template for the revised Treasury Management Policy Statement. It is also a requirement of the Code that this Council should formally adopt the Code. As the Code has been revised, there is a separate appendix to this report where the Council is asked to adopt the revised Code (Appendix D) and the revised Treasury Management Policy Statement (Appendix C).

The revised Code has emphasised a number of key areas including the following: -

- a) All councils must formally adopt the revised Code and four clauses

- b) The strategy report will affirm that the effective management and control of risk are prime objectives of the Council's treasury management activities.
- c) The Council's appetite for risk must be clearly identified within the strategy report and will affirm that priority is given to security of capital and liquidity when investing funds and explain how that will be carried out.
- d) Responsibility for risk management and control lies within the organisation and cannot be delegated to any outside organisation.
- e) Credit ratings should only be used as a starting point when considering risk. Use should also be made of market data and information, the quality financial press, information on government support for banks and the credit ratings of that government support.
- f) Councils need a sound diversification policy with high credit quality counterparties and should consider setting country, sector and group limits.
- g) Borrowing in advance of need is only to be permissible when there is a clear business case for doing so and only for the current capital programme or to finance future debt maturities.
- h) The main annual treasury management reports MUST be approved by full council.
- i) There needs to be, at a minimum, a mid year review of treasury management strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved.
- j) Each council must delegate the role of scrutiny of treasury management strategy and policies to a specific named body.
- k) Treasury management performance and policy setting should be subjected to prior scrutiny.
- l) Members should be provided with access to relevant training.
- m) Those charged with governance are also personally responsible for ensuring they have the necessary skills and training.
- n) Responsibility for these activities must be clearly defined within the organisation.
- o) Officers involved in treasury management must be explicitly required to follow treasury management policies and procedures when making investment and borrowing decisions on behalf of the Council (this will form part of the updated Treasury Management Practices).

This strategy statement has been prepared in accordance with the revised Code. Accordingly, the Council's Treasury Management Strategy will be approved annually by the full board/council. In addition there will be monitoring reports and regular review by board members in both executive and scrutiny functions. 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.

This Council will adopt the following reporting arrangements in accordance with the requirements of the revised Code: -

Area of Responsibility	Council/ Committee/ Officer	Frequency
Treasury Management Policy Statement (revised)	Full council	Initial adoption in 2010

Treasury Management Strategy / Annual Investment Strategy / MRP policy	Full council	Annually before the start of the year
Treasury Management Strategy / Annual Investment Strategy / MRP policy – updates or revisions at other times	Full council	As and when necessary
Annual Treasury Outturn Report	Full council	Annually by 30 September reporting on activity for the previous financial year.
Treasury Management Monitoring Reports	Audit Committee	Annually by 30 November reporting on activity in the first 6 months.
Scrutiny of treasury management strategy	Resource and Governance Overview and Scrutiny Committee	Annually before the start of the year
Scrutiny of treasury management performance	Audit Committee	As and when necessary

## 1.2 Revised CIPFA Prudential Code

CIPFA has also issued a revised Prudential Code which primarily covers borrowing and the Prudential Indicators. Three of these indicators have now been moved from being Prudential Indicators to being Treasury Indicators: -

- authorised limit for external debt
- operational boundary for external debt
- actual external debt.

However, all indicators are to be presented together as one suite. In addition, where there is a significant difference between the net and the gross borrowing position, the risks and benefits associated with this strategy should be clearly stated in the annual strategy.

## 1.3 Revised Investment Guidance

It should also be noted that the Department of Communities and Local Government is currently undertaking a consultation exercise on draft revised investment guidance which will result in the issue of amended investment guidance for English local authorities to come into effect from 1 April 2010. It is not currently expected that there will be any major changes required over and above the changes already required by the revised Code.

## 1.4 Treasury Management Strategy for 2010/11

The Local Government Act 2003 (the Act) and supporting regulations 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 three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued

subsequent to the Act) (included as Section 7 of this report); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The suggested strategy for 2010/11 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser, Sector Treasury Services.

The strategy covers:

Section 1.	Introduction
Section 2.	Treasury Limits for 2010/11 to 2012/13
Section 3.	Current Portfolio Position
Section 4.	Borrowing Requirement
Section 5.	Prudential and Treasury Indicators for 2010/1 to 2012/13
Section 6.	Borrowing Strategy and prospects for Interest rates
Section 7.	Annual Investment Strategy
Section 8.	MRP Strategy
Section 9.	Recommendations
Appendix A	List of Prudential and Treasury Indicators for approval
Appendix B	MRP Strategy
Appendix C	Treasury Management Policy Statement
Appendix D	Adoption of Revised CIPFA Treasury Management Code of Practice 2009
Appendix E	Treasury management scheme of delegation
Appendix F	The treasury management role of the section 151 officer
Appendix G	Economic Background
Appendix H	Prospects for Interest Rates
Appendix I	Glossary of Terms

### **1.5 Balanced Budget Requirement**

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

-

- increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
- Any increases in running costs from new capital projects are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

## 2.0 Treasury Limits for 2010/11 to 2012/13

- 2.1 There is a statutory duty, under section 3 of the Local Government Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the Authorised Limit.
- 2.2 The Council must have regard to the Prudential Code when setting the Authorised Limit, which, essentially, requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax/rent levels is acceptable.
- 2.3 Whilst termed an “Affordable Borrowing Limit”, the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years, details of the Authorised Limit can be found in appendix A of this report.

## 3.0 Current Portfolio Position

The Council’s estimated treasury portfolio position at 31 March 2010 will comprise:

		Principal		Ave. rate
		£m	£m	%
Fixed rate funding	PWLB	131,162		3.96
	Market	368,250		4.79
	Stock	8,224		3.36
			507,636	
Variable rate funding	PWLB	0		
	Market	181,390		5.1
			181,390	
Other long term liabilities			0	
<b>Gross debt</b>			<b>689,026</b>	
Investments			0	
<b>Net debt</b>			<b>689,026</b>	

## 4.0 Borrowing Requirement

The potential long-term borrowing requirements over the next three years, are as follows:

Table 2	2010/11	2011/12	2012/13
	£'000	£'000	£'000
	estimate	estimate	estimate

Potential New Borrowing	195,000	98,000	98,000
-------------------------	---------	--------	--------

## 5.0 Treasury Indicators for 2010/11 to 2012/13

Treasury Indicators (as set out in appendix A to this report) are relevant for the purposes of setting an integrated treasury management strategy.

The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This original 2001 Code was adopted on 8 October 2003 by the full Council and the revised Code will be adopted on 3 March 2010.

## 6.0 Borrowing Strategy and Prospects for Interest Rate

### 6.1 Interest rates

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. Appendix H draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Sector central view.

#### Sector Bank Rate forecast for financial year ends (March)

- 2010 0.50%
- 2011 1.50%
- 2012 3.50%
- 2013 4.50%

There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected. A detailed view of the current economic background is contained within appendix G to this report.

### 6.2 Borrowing rates

The Sector forecast for the PWLB new borrowing rate is as follows: -

	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Mar-12	Mar-13
Bank rate	0.50%	0.50%	0.75%	1.00%	1.50%	3.50%	4.50%
5yr PWLB rate	3.05%	3.20%	3.30%	3.40%	3.60%	4.60%	4.85%
10yr PWLB rate	4.00%	4.05%	4.15%	4.30%	4.45%	5.00%	5.15%
25yr PWLB rate	4.55%	4.65%	4.70%	4.80%	4.90%	5.20%	5.35%
50yr PWLB rate	4.60%	4.70%	4.75%	4.90%	5.00%	5.30%	5.45%

A more detailed Sector forecast is included in appendix H.

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

- Rates are expected to gradually increase during the year so it should therefore be advantageous to time new long term borrowing for the start of the year when 25 year PWLB rates fall back to or below the central forecast rate of about 4.65%, a suitable trigger point for considering new fixed rate long term borrowing.
- Variable rate borrowing is expected to be cheaper than long term borrowing and will therefore be attractive throughout the financial year compared to taking long term fixed rate borrowing.
- PWLB rates on loans of less than ten years duration are expected to be substantially lower than longer term PWLB rates offering a range of options for new borrowing which will spread debt maturities away from a concentration in long dated debt.
- Consideration will also be given to borrowing fixed rate market loans at 25 – 50 basis points below the PWLB target rate and to maintaining an appropriate balance between PWLB and market debt in the debt portfolio.

**Sensitivity of the forecast** – In normal circumstances the main sensitivities of the forecast are likely to be the two scenarios noted below. The Council officers, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

- *if it were felt that there was a significant risk of a sharp FALL in long and short term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.*
- *if it were felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.*

### 6.3 External v. internal borrowing

- This Council currently has a minimal difference between gross debt and net debt.
- The current borrowing position reflects the strong balance sheet of the council. It enables net interest costs to be minimised and reduces credit risk by making temporary use of internal borrowing (reserves, provisions, positive cash flows etc). Although some new borrowing has been taken in 2009/10 the policy remains to keep cash as low as possible and minimise temporary investments.
- The next financial year is expected to be one of historically abnormally low Bank Rate. This provides a continuation of the current window of opportunity for local authorities to fundamentally review their strategy of undertaking new external borrowing.
- Over the next three years, investment rates are therefore expected to be below long term borrowing rates and so value for money considerations would indicate that value could best be obtained by avoiding new external borrowing and by using internal cash

balances to finance new capital expenditure or to replace maturing external debt (this is referred to as internal borrowing). This would maximise short term savings.

- However, short term savings by avoiding new long term external borrowing in 2010/11 will also be weighed against the potential for incurring additional long term extra costs by delaying unavoidable new external borrowing until later years when PWLB long term rates are forecast to be significantly higher.
- The Council has examined the potential for undertaking early repayment of some external debt to the PWLB in order to reduce the difference between its gross and net debt positions. However, the introduction by the PWLB of significantly lower repayment rates than new borrowing rates in November 2007 has meant that large premiums would be incurred by such action and would also do so in the near term; such levels of premiums cannot be justified on value for money grounds. This situation will be monitored in case the differential is narrowed by the PWLB or when repayment rates rise substantially.

Against this background caution will be adopted with the 2010/11 treasury operations. The City Treasurer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to the appropriate decision making body at the next available opportunity.

#### **6.4 Policy on borrowing in advance of need**

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.

#### **6.5 Debt Rescheduling**

The introduction of the new PWLB rates structure on 1 November 2007 that introduced a spread between the rates applied to new borrowing and repayment of debt, has meant that PWLB to PWLB debt restructuring is now much less attractive than before that date. However, significant interest savings may still be achievable through using LOBOs (Lenders Option Borrowers Option) loans and other market loans in rescheduling exercises.

As short term borrowing rates will be considerably cheaper than longer term rates, there are likely to be significant opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of their short term nature and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio. Any such

rescheduling and repayment of debt is likely to cause a flattening of the Council's maturity profile as in recent years there has been a skew towards longer dated PWLB.

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings,
- helping to fulfil the strategy outlined above, and
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

There has been much discussion as to whether the size of spread between long term PWLB repayment and new borrowing rates should be revised (downwards) in order to help local authorities currently dissuaded from using investment cash balances to repay long term borrowing and thereby reduce counterparty and interest rate risk exposure. The DMO / PWLB have issued a consultation document with suggested options to revise the methodology used to calculate the early repayment rate. The consultation period ended in January 2010 and this authority will monitor developments in this area and may amend its strategy if significant changes are introduced.

Any rescheduling will be reported to the Executive at the earliest meeting following its action.

## **7.0 Annual Investment Strategy**

### **7.1 Investment Policy**

The Council will have regard to the CLG's Guidance on Local Government Investments ("the Guidance") issued in March 2004, any revisions to that guidance, the Audit Commission's report on Icelandic investments and the 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are: -

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

The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investment.

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

Investment instruments identified for use in the financial year are listed below. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

These principles would be important in normal circumstances, but the last two years or so have been anything but. The Icelandic banks crisis, which did not impact on the City Council, along with the financial difficulties faced by UK and international banks, have placed security of investments at the forefront of Treasury Management investment policy.

In order to achieve a higher level of security, the City Treasurer has introduced a number of measures:-

- Investments to be restricted to UK banks, building societies, local authorities and UK Government institutions. (If as the year progresses the Council needs to spread its counterparty risk by identifying more counterparties than currently operate in the UK, the Treasurer may seek approval to remove this restriction, so that none UK institutions can be considered as counterparties. Any proposal to do this, along with the restrictions in the proposed use of none UK banks will be reported to members for approval before any deposits are made).
- Diversify the investment portfolio into more secure UK government and government backed investment instruments.
- Although current investment strategy allows investments up to 364 days, restrict deposits to as short a time period as feasible.

There is a price to pay for an increased level of security, however. Greater security, and reduced exposure to risk, can only be achieved at the cost of lower rates of return.

Members are asked to note the revised Treasury Management investment strategy.

## 7.2 Specified and Non-Specified Investments

Investment instruments identified for use in the financial year are listed below under 'Specified' and 'Non-Specified' Investments categories.

### Specified Investments

All such investments are sterling denominated, with maturities up to maximum of 1 year, meeting the minimum 'high' rating criteria where applicable.

	<b>Minimum 'High' Credit Criteria</b>	<b>Use</b>
Term deposits – banks and building societies *	See below	In-house
Term deposits – other Local Authorities (LAs)	High security. Only one or two LAs credit rated	In-house
Debt Management Agency Deposit Facility	UK Government Backed	In-house
Nationalised banks	UK Government Backed	In-house
Certificates of deposits issued by banks and building societies covered by UK Government guarantees**	UK Government explicit guarantee	In-house

\* Banks

Have as a minimum the following Fitch (or equivalent) credit ratings (where rated):

- i. Long Term - Fitch A
- ii. Short Term - Fitch F1
- iii. Support - Fitch 3

Building Societies

Have as a minimum the following Fitch (or equivalent) credit ratings (where rated):

- i. Long Term - Fitch A-

- ii. Short Term - Fitch F2
- iii. Support - Fitch 3

\*\* Banks supported by the UK bail-out package: -

- Abbey
- Barclays
- HBOS
- Lloyds TSB
- HSBC
- Nationwide Building Society
- RBS
- Standard Chartered

### 7.3 Investment Limits

As advised by Sector, our treasury advisers, the financial investment limits of banks and building societies are linked to their Fitch long-term ratings (or Moodys equivalent), as follows:-

#### Banks

Fitch AA+	£20 million
Fitch AA/AA-	£15 million
Fitch A+/A	£10 million

#### Building Societies

Fitch AA/AA-	£15 million
Fitch A+/A-	£10 million

Debt Management Office	£100m
District Councils	£5m
Other Local Authorities	£10m

### 7.4 Liquidity

Based on cash flow forecasts, the level of cash balances in 2010-11 is estimated to range between £0m and £70m. The higher level can sometimes arise where, for instance, large government grants are received or long term borrowing has recently been undertaken.

Giving due consideration to the Council's level of balances over the next year, the need for liquidity, its spending commitments and provisioning for contingencies, it is considered very unlikely that the Council will have cash balances to invest other than on a temporary basis. For this reason, no cash will be held in term deposit maturities in excess of 1 year.

### 7.5 Creditworthiness policy

This Council uses the creditworthiness service provided by Sector. This service has been progressively enhanced over the last year 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

- CDS spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries

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 code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments and are therefore referred to as durational bands. The Council is satisfied that this service now gives a much 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.

The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Sector's weekly credit list of worldwide potential counterparties. The Council will therefore use counterparties within the following durational bands: -

- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months

This Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties as Moodys are currently very much more aggressive in giving low ratings than the other two agencies. This would therefore be unworkable and leave the Council with few banks on its approved lending list. The Sector creditworthiness service does though, use ratings from all three agencies, but by using a scoring system, does not give undue preponderance to just one agency's ratings.

All credit ratings will be monitored weekly. 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 Credit Default Swap against the iTraxx benchmark (The Markit iTraxx Senior Financials Index is a composite of the 25 most liquid financial entities in Europe. The index is calculated through an averaging process by the Markit Group and is used as the benchmark level of CDS spreads on Sector's Credit List) and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list.

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

## **7.6 Investment Strategy to be followed in-house**

Bank Rate has been unchanged at 0.50% since March 2009. Bank Rate is forecast to commence rising in quarter 3 of 2010 and then to rise steadily from thereon. Bank Rate forecasts for financial year ends (March) are as follows: -

- **2010** 0.50%
- **2011** 1.50%
- **2012** 3.50%
- **2013** 4.50%

There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected.

The Council will avoid locking into longer term deals while investment rates are down at historically low levels unless exceptionally attractive rates are available which make longer term deals worthwhile.

For 2010/11 it is suggested that the Council should budget for an investment return of 0.90% on investments placed during the financial year.

For its cash flow generated balances, the Council will seek to utilise its business reserve accounts and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

### **7.7 End of year Investment Report**

At the end of the financial year, the Council will receive report on its investment activity as part of its Annual Treasury Report.

### **7.8 Policy on the use of external service providers**

The Council uses Sector Treasury Services and Butlers as its external treasury management advisers.

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

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

### **7.9 Scheme of delegation**

To define responsibility to member groups and officers in relation to treasury management.

Please see appendix E.

### **7.10 Role of the section 151 officer**

Define the role of City Treasurer in relation to treasury management.

Please see appendix F.

## **8.0 Minimum Revenue Provision (MRP) Strategy**

Outline Council policy for spreading capital expenditure charge to revenue and through annual MRP charge.

Please see attached Appendix B

## **9.0 Recommendations**

Please see front of report for list of recommendations.

**Appendix A**

**List of Treasury Indicators for approval**

Please note last years approved figures are shown in brackets

Treasury management indicators	2010/11		2011/12		2012/13
	£m		£m		£m
<b>Authorised Limit for external debt -</b>					
borrowing	1,187	(1,167)	1,132	(1,167)	1,200
other long term liabilities (note 1)	206	(0)	206	(0)	206
<b>TOTAL</b>	<b>1,393</b>	<b>(1,167)</b>	<b>1,338</b>	<b>(1,167)</b>	<b>1,406</b>
<b>Operational Boundary for external debt -</b>					
borrowing	1,040	(1,060)	1,059	(1,108)	1,132
other long term liabilities (note 1)	206	(0)	206	(0)	206
<b>TOTAL</b>	<b>1,246</b>	<b>(1,060)</b>	<b>1,265</b>	<b>(1,108)</b>	<b>1,338</b>
<b>Actual external debt</b>	885		983		1,081
<b>Upper limit for fixed interest rate exposure</b>					
Net borrowing at fixed rates as a % of total net borrowing	83%	(79%)	85%	(80%)	86%
<b>Upper limit for variable rate exposure</b>					
Net borrowing at Variable rates as a % of total net borrowing	56%	(89%)	65%	(93%)	74%
<b>Upper limit for total principal sums invested for over 364 days</b>	0	(0)	0	(0)	0

Maturity structure of new fixed rate borrowing during 2010/11	Upper Limit		Lower limit	
	under 12 months	50%	(50%)	0%
12 months and within 24 months	60%	(60%)	0%	(10%)
24 months and within 5 years	80%	(70%)	30%	(10%)
5 years and within 10 years	60%	(60%)	0%	(0%)
10 years and above	60%	(60%)	10%	(10%)

Note 1 – This increase is due to the move to International Financial Reporting Standards which means assets held under a PFI scheme must be included on the council's balance sheet. There are approximately 2700 council houses, 2 schools, 100k street lights, 183m

energy systems for number of block of flats. Also several leases have been re-categorised as finance leases from operating leases and must be included on the balance sheet.

**Appendix B**

**Minimum Revenue Policy Strategy**

The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2009/10 and will assess its MRP for 2010/11 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

The Council is required to make provision for repayment of an element of the accumulated General Fund capital spend each year through a revenue charge (the Minimum Revenue Provision - MRP).

CLG Regulations require full Council to approve an MRP Statement. This will need to be approved in advance of each year. If the Council wishes to amend its policy during the year this would need to be approved by full Council. A variety of options were provided to councils to replace the previous Regulations, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:-

For non HRA supported capital expenditure, MRP policy will continue to be charged at a rate of 4% in accordance with option 1 of the guidance (the regulatory method).

For non HRA unsupported capital expenditure incurred the MRP policy will be:  
Asset Life Method – MRP will be based on a straight line basis or annuity method so linking the MRP to the future flow of benefits from the asset, dependant on the nature of the capital expenditure, in accordance with option 3 of the guidance. The MRP will start in the year after the capital expenditure is incurred or, in the case of new operational assets, in the year following the asset becomes operational, in accordance with the guidance.

For non HRA capital expenditure funded by borrowing in relation to expenditure which is capital by virtue of a Ministerial direction, or is capital expenditure which does not create a council asset, MRP will be provided as follows, starting in the year after the capital expenditure is incurred or, in the case of new assets, in the year following the asset becomes operational, in accordance with the guidance.

This will also apply for any expenditure capitalised under a Capitalisation Directive.

<b>Expenditure type</b>	<b>Maximum period over which MRP to be made</b>
Expenditure capitalised by virtue of a direction under s16 (2) (b).	20 years.
Regulation 25(1) (a). Expenditure on computer programs.	Same period as for computer hardware.
Regulation 25(1) (b). Loans and grants towards capital expenditure by third parties.	The estimated life of the assets in relation to which the third part expenditure is incurred.
Regulation 25(1) (c). Repayment of grants and loans for capital expenditure.	25 years or the period of the loan if longer.

Regulation 25(1) (d). Acquisition of share or loan capital.	20 years.*
Regulation 25(1) (e). Expenditure on works to assets not owned by the authority.	The estimated life of the assets.
Regulation 25(1) (ea). Expenditure on assets for use by others.	The estimated life of the assets.
Regulation 25(1) (f). Payment of levy on Large Scale Voluntary Transfers (LSVTs) of dwellings.	25 years.

\* The recommended policy is in line with the guidance, but it is recommended that the policy in relation to Regulation 25(1) (d) items should be amended to equal the estimated life of assets associated with the acquisition expenditure.

The move to International Accounting Standards will involve arrangements under private finance initiatives (PFIs) and lessee interests being accounted for on the Council's balance sheet. Where this happens, a part of the service charge or rent payable will be taken to reduce the balance sheet liability rather than being charged as revenue expenditure. The MRP element of these schemes will be the amount of service charge or rental payment now charged against the balance sheet liability. This approach will produce an MRP charge comparable to that under option 3 in that it will run over the life of the lease or PFI scheme.

**Appendix C**

**Treasury Management Policy Statement**

1. This organisation defines its treasury management activities as: “The management of the authority’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks”.
2. This organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.
3. This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.”

## **Appendix D**

### **Adoption of revised CIPFA Treasury Management Code of Practice 2009**

#### **INTRODUCTION**

The CIPFA Code of Practice on Treasury Management in Local Authorities was last updated in 2001 and has been revised in 2009 in the light of the default by Icelandic banks in 2008. The revised Code requires that a report be submitted to the council, board or other appropriate body, setting out four amended clauses which should be formally passed in order to approve adoption of the new version of the Code of Practice and Cross-Sectoral Guidance Notes.

The revised Code also includes an amended version of the treasury management policy statement (TMPS) incorporating just three clauses and a revised definition of treasury management activities. The Code does not require this statement to be approved by the council, board or other appropriate body.

The revised Code has also set out various requirements which have been summarised in paragraph 1 of the latest Treasury Management Strategy Statement.

#### **RESOLUTIONS**

CIPFA recommends that all public service organisations adopt, as part of their standing orders, financial regulations, or other formal policy documents appropriate to their circumstances, the following four clauses.

1. This organisation will create and maintain, as the cornerstones for effective treasury management:
  - a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities
  - suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the Code's key principles.

2. This organisation (i.e. full board/council) will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.

3. This organisation delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Audit Committee, and for the execution and administration of treasury management decisions to the City Treasurer, who will act in accordance with the organisation's policy statement and TMPs and, if he is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

4. This organisation nominates Resource and Governance Overview and Scrutiny Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

## **Appendix E**

### **Treasury management scheme of delegation**

#### **(i) Full council**

- receiving and reviewing reports on treasury management policies, practices and activities
- approval of annual strategy.

#### **(ii) Responsible body – Audit Committee**

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices
- budget consideration and approval
- approval of the division of responsibilities
- receiving and reviewing regular monitoring reports and acting on recommendations
- approving the selection of external service providers and agreeing terms of appointment.

#### **(iii) Body with responsibility for scrutiny - Resource and Governance Overview and Scrutiny Committee**

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

#### **(iv) City Treasurer**

- Delivery of the function
-

## **Appendix F**

### **The treasury management role of the section 151 officer**

#### **The S151 (responsible) officer**

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers.
-

## **Appendix G**

### **Economic Background**

#### **1. Introduction**

- The credit crunch storm of August 2007 eventually fed through to the near collapse of the world banking system in September 2008. This then pushed most of the major economies of the world into a very sharp recession in 2009 accompanied by a dearth of lending from banks anxious to rebuild their weakened balance sheets. Many governments were forced to recapitalise and rescue their major banks and central banks precipitately cut their central bank rates to 0.10 – 1.00% in order to counter the recession.
- The long awaited start of growth eventually came in quarter 3 2009 in the US and the EU. However, there was disappointment that the UK failed to emerge from recession in quarter 3.
- Inflation has plunged in most major economies and is currently not seen as being a problem for at least the next two years due to the large output gaps and high unemployment putting a lid on wage growth. In many countries there have been widespread pay freezes in 2009 and these are likely to be persistent for some time.
- Deflation could become a threat in some economies if they were to go into a significant double dip recession.
- Asian countries, especially China, are buoying world demand through their own stimulus measures.
- There still needs to be a radical world rebalancing of excess savings rates by cash rich Asian and oil based economies and excess consumption rates in Western economies if the world financial system is not to avoid a potential rerun of this major financial crisis in years to come.
- Most major economies have resorted to a huge expansion of fiscal stimulus packages in order to encourage a fast exit from recession. This, together with expenditure on direct support provided to ailing banks, has led to a drastic expansion in government debt levels which will take many years to eliminate and to restore the previous health of national finances.

#### **2 Two growth scenarios**

- The current big issue is ‘how quickly will the major world economies recover?’ There is a sharp division of opinion on this question as set out below. The knock on effects on forecasts for interest rates can be seen in appendix H – UBS strong recovery, Capital Economics – weak recovery.

##### **2.1 Strong recovery**

- This is a normal cyclical recovery which will be strong in the major world economies. The US still has potential to add further fiscal stimulus in 2010 to ensure that strong recovery continues after the current round of stimulus measures end. Growth in the EU is likely to be strong in 2010 and not require such help.

##### **The UK:**

- GDP growth will almost get back to the long term average of about 2.5% in 2011 but is likely to peak in the first half of the year as inventory rebuilding and stimulus measures fade and fiscal contraction kicks in later in the year.

- The economy will rebalance with strong growth in exports and import substitution helped by strong recovery in the EU and the rest of the world.
- Sterling has depreciated by 25% since the peak in 2007 and is likely to stay weak.
- Consumer spending – only a mediocre recovery is expected due to a steady increase in the savings ratio from +5.6% in 2009 to about 8% in 2011 as consumers pay down debt or build cash balances. Consumer incomes will be held down by wage freezes and increases in taxation.
- House price recovery is expected to persist helped by a low Bank Rate for a prolonged period; the peak to trough fall in house prices is now expected to be no more than 20%. House prices to rise by about 6% in 2010, and 3% in 2011; mortgage approvals will rise back to the level of 75 - 80,000 per month needed to ensure a continuation of a trend of rising house prices.
- CPI inflation to peak @ 2.5% in early 2010 after the rise in VAT in January but then to fall to a trough near 1.5% in early 2011 and to stay below 2% for the rest of 2011.
- The current MPC attitude is one of hang on as long as possible before increasing Bank Rate. The aim of this would be to try to ensure that growth gets going at a decent rate and that Bank Rate gets back to 4 – 5% before the next recession and that all assets purchased through QE have been sold off by then. The first Bank Rate increase is expected in Q3 2009.
- If there is a change of Government in 2010 with a more aggressive fiscal approach then this could delay the timing of Bank Rate starting to go up.
- The fiscal deficit is 6.4% of GDP, about £90bn, which is expected to fall at £11bn p.a. over eight years at currently planned rates. This is similar to the peak deficit of 7% in 1990s which was remedied to a surplus of 1.6% in the space of 6 years helped by strong, steady economic growth of 3% p.a. supported by loose monetary policy that compensated for the fiscal squeeze.
- Gilt yields, especially longer term ones, are currently artificially low due to the Bank of England's Quantitative Easing operations. £200bn of gilts, commercial bonds and paper are being purchased under this scheme which has inflated prices and depressed yields. Once this campaign ends, yields will inevitably rise but will also rise due to the huge level of issuance of new gilts to finance the fiscal deficit. Long gilt yields are therefore forecast to reach 6% during 2011.
- Gilt yields could rise higher if there was a hung Parliament in 2010 or if the fiscal situation deteriorates further.
- The major risk to this scenario would be a lack of supply of bank credit. However, it is felt that the Bank of England is on alert to ensure that this does not happen and would continue various measures to assist the expansion of credit.

## **2.2 Weak recovery**

- The current economic cycle is not a normal business cycle but a balance sheet driven cycle. Over borrowed banks, corporates and consumers are focused on shrinking their levels of borrowing to more viable and affordable levels and this balance sheet adjustment will take several years to be effected. Repayment of debt will therefore act as a major head wind to the required increase in demand in the economy. Consequently there will only be weak economic recovery over the next few years after the initial sharp inventory rebuilding rebound fades. GDP growth is forecast to reach only +1.5% in 2011.

- Fiscal contraction will further dampen economic recovery driven by a strong political agenda to accelerate cuts in expenditure and increases in taxation after the general election in 2010.
- The consumer savings ratio will rise so as to eliminate over borrowing and to insure against people losing their jobs during this downturn. This will depress consumer expenditure, the main driver of the UK economy.
- Growth will also be hampered by a reduced supply of credit from weakened banks compounded by weak demand for credit.
- The eventual reversal of Quantitative Easing will take cash out of the economy and reduce demand in the economy.
- Unemployment is likely to rise to near to 3m in 2010 and take years to subside due to weak growth. High unemployment will reduce tax income and increase expenditure on benefits and the costs of local authority services.
- Inflation will not be a threat for several years as the current 6% output gap will take until 2014 to be eliminated.
- However, deflation is a major danger for some years: the major falls in manufacturing prices over the last 12 -18 months have still to feed through to the economy and then to impact wage deflation.
- CPI inflation will blip up over 2% in early 2010 but will then be on a strong downward trend to about -1% in 2011.
- There is no need for the MPC to change Bank Rate from 0.5% in 2010 or 2011 and possibly for 5 years as they will need to counter the fiscal contraction which will dampen demand in the economy.
- Long PWLB rates will FALL from current levels to near 4% in 2010 due to weak economic recovery and minimal inflation so that the real rate of return (net of inflation) on long gilts is healthy at these low levels

### 2.3 Sector view

- Sector recognises that at the current time it is difficult to have confidence as to exactly how strong the UK economic recovery will prove to be. Both the above scenarios are founded on major assumptions and research which could or could not turn out to be correct.
- Sector has adopted a more moderate view between these two scenarios outlined above i.e. a moderate return to growth.
- We do, however, feel that the risks that long term gilt yields and PWLB rates will rise markedly are high.
- There are huge uncertainties in all forecasts due to the major difficulties of forecasting the following areas: -
  - degree of speed and severity of fiscal contraction after the general election
  - timing and amounts of the reversal of Quantitative Easing,
  - speed of recovery of banks' profitability and balance sheet imbalances
  - changes in the consumer savings ratio
  - rebalancing of the UK economy towards exporting and substituting imports
- The overall balance of risks is weighted to the downside i.e. the pace of economic growth disappoints and Bank Rate increases are delayed and / or lower
- There is an identifiable risk of a double dip recession and deleveraging creating a downward spiral of falling demand, falling jobs and falling prices and wages leading to

deflation but this is considered to be a small risk and an extreme view at the current  
time on the basis of current evidence.

## Appendix H

### Prospects for Interest Rates

The data below shows a variety of forecasts published by a number of institutions, they are individual forecasts including those of UBS and Capital Economics (an independent forecasting consultancy).

The forecast within this strategy statement has been drawn from these diverse sources and officers' own views.

### 1. INDIVIDUAL FORECASTS

#### Sector interest rate forecast – 23.11.09

	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
Bank rate	0.50%	0.50%	0.75%	1.00%	1.50%	2.25%	2.75%	3.25%	3.50%	3.75%	4.25%	4.25%	4.50%
5yr PWLB rate	3.05%	3.20%	3.30%	3.40%	3.60%	3.85%	4.15%	4.55%	4.60%	4.80%	4.80%	4.85%	4.85%
10yr PWLB rate	4.00%	4.05%	4.15%	4.30%	4.45%	4.60%	4.80%	4.90%	5.00%	5.10%	5.10%	5.15%	5.15%
25yr PWLB rate	4.55%	4.65%	4.70%	4.80%	4.90%	5.00%	5.05%	5.10%	5.20%	5.30%	5.30%	5.35%	5.35%
50yr PWLB rate	4.60%	4.70%	4.75%	4.90%	5.00%	5.10%	5.15%	5.20%	5.30%	5.40%	5.40%	5.45%	5.45%

#### Capital Economics interest rate forecast – 18.1.10

	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
5yr PWLB rate	3.15%	2.95%	2.65%	2.45%	2.45%	2.45%	2.45%	2.45%
10yr PWLB rate	4.45%	4.15%	3.65%	3.15%	3.15%	3.15%	3.15%	3.15%
25yr PWLB rate	4.75%	4.65%	4.35%	4.05%	3.95%	3.75%	3.75%	3.75%
50yr PWLB rate	4.65%	4.65%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%

#### UBS interest rate forecast (for quarter ends) – 30.10.09

	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
Bank Rate	0.50%	0.50%	0.75%	1.00%	1.50%	2.00%	2.50%	3.00%
10yr PWLB rate	3.90%	4.05%	4.40%	4.75%	4.90%	5.15%	5.40%	5.40%
25yr PWLB rate	4.45%	4.65%	5.00%	5.15%	5.40%	5.65%	5.90%	5.90%
50yr PWLB rate	4.55%	4.75%	5.10%	5.25%	5.50%	5.75%	6.00%	6.00%

## Appendix I

### Glossary of Terms

**Authorised Limit** - This Prudential Indicator represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable. It is the expected maximum borrowing need, with some headroom for unexpected movements.

**Bank Rate** – the rate at which the Bank of England offers loans to the wholesale banks, thereby controlling general interest rates in the economy.

**Counterparty** – one of the opposing parties involved in a borrowing or investment transaction

**Credit Rating** – A qualified assessment and formal evaluation of an institution's (bank or building society) credit history and capability of repaying obligations. It measures the probability of the borrower defaulting on its financial obligations, and its ability to repay these fully and on time.

**Discount** – Where the prevailing interest rate is higher than the fixed rate of a long-term loan, which is being repaid early, the lender can refund the borrower a discount, the calculation being based on the difference between the two interest rates over the remaining years of the loan, discounted back to present value. The lender is able to offer the discount, as their investment will now earn more than when the original loan was taken out.

**Fixed Rate Funding** - A fixed rate of interest throughout the time of the loan. The rate is fixed at the start of the loan and therefore does not affect the volatility of the portfolio, until the debt matures and requires replacing at the interest rates relevant at that time.

**Gilts** - The loan instruments by which the Government borrows. Interest rates will reflect the level of demand shown by investors when the Government auctions Gilts.

**High/Low Coupon** – High/Low interest rate

**Liquidity** – The ability of an asset to be converted into cash quickly and without any price discount. The more liquid a business is, the better able it is to meet short-term financial obligations.

**Market** - The private sector institutions - Banks, Building Societies etc.

**Maturity Profile/Structure** - an illustration of when debts are due to mature, and either have to be renewed or money found to pay off the debt. A high concentration in one year will make the Council vulnerable to current interest rates in that year.

**Monetary Policy Committee** – the independent body that determines Bank Rate.

**Operational Boundary** – This Prudential Indicator is based on the probable external debt during the course of the year. It is not a limit and actual borrowing could vary around this boundary for short times during the year. It should act as an indicator to ensure the Authorised Limit is not breached.

**Premium** – Where the prevailing current interest rate is lower than the fixed rate of a long-term loan, which is being repaid early, the lender can charge the borrower a premium, the calculation being based on the difference between the two interest rates over the remaining years of the loan, discounted back to present value. The lender may charge the premium, as their investment will now earn less than when the original loan was taken out.

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

**PWLB** - Public Works Loan Board. Part of the Government's Debt Management Office, which provides loans to public bodies at rates reflecting those at which the Government is able to sell Gilts.

**Specified Investments** - Sterling investments of not more than one-year maturity. These are considered low risk assets, where the possibility of loss of principal or investment income is very low.

**Non-specified investments** - Investments not in the above, specified category, e.g., foreign currency, exceeding one year or outside our minimum credit rating criteria.

**Variable Rate Funding** - The rate of interest either continually moves reflecting interest rates of the day, or can be tied to specific dates during the loan period. Rates may be updated on a monthly, quarterly or annual basis.

**Volatility** - The degree to which the debt portfolio is affected by current interest rate movements. The more debt maturing within the coming year and needing replacement, and the more debt subject to variable interest rates, the greater the volatility.

**Yield Curve** - A graph of the relationship of interest rates to the length of the loan. A normal yield curve will show interest rates relatively low for short-term loans compared to long-term loans. An inverted Yield Curve is the opposite of this.