SUMMARY

This annual report informs the Council of the treasury management strategy for the coming financial year. The report fulfils two key legislative requirements – the reporting of:

the treasury management strategy and treasury management indicators as required by the CIPFA Treasury Management Code of Practice; and

- the investment strategy in accordance with CLG Investment Guidance.

Action proposed by the Lead Member for Finance and Resources:

1. Approve the Treasury Management Strategy 2014/15, and the Treasury Management Indicators as set out in paragraph 53 of the report and RECOMMEND to the Council for adoption;

2. Approve the Investment Strategy 2014/15 contained in the treasury management strategy, and the detailed criteria included in Attachment 2 and RECOMMEND to the Council for adoption.

Reason for action proposed

To comply with statutory requirements and the CIPFA Code of Practice on Treasury Management.

Introduction

1. Treasury Management is about managing the Council’s cash flow, borrowing and cash investments to support Kingston’s finances and is an important part of the overall financial management of the Council’s affairs. The sums of money managed are very significant and no treasury management activity is without risk. The effective identification and management of risk are therefore central to the Council’s treasury management strategy.

2. The Council’s treasury management activities are regulated by statute, professional codes and official investment guidance. In February 2012 the Council adopted the Chartered Institute of Public Finance and Accountancy’s (CIPFA) Treasury Management Code of Practice 2011 Edition (the CIPFA Code), and a Treasury Management Policy Statement (Enclosure 1) as recommended under the CIPFA Code.

3. The CIPFA Code requires the Council to approve the annual strategy report before the start of the financial year. The report also includes the annual Investment Strategy that is a requirement of the Department for Communities and Local Government’s (CLG) Investment Guidance.
4. A further report on actual activity for the year is presented to the Audit Committee after the end of the financial year. A mid-year review report is also presented to the Audit Committee during the year with the latest one for 2013-14 presented to the Audit Committee on 11 December 2013. The report included for scrutiny the Council’s Treasury Management Practices (TMPs), which set out the manner in which the Council seeks to achieve its treasury management policies and objectives, and prescribes how activities are managed and controlled.

5. **Treasury Management Advisors** - The Council 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. The Council currently employs Arlingclose Ltd as treasury management advisors and receives specific advice on investment, debt and capital finance issues.

6. Whilst the advisors provide support to the internal treasury function, under current market rules and the CIPFA Code the final decision on treasury matters remains with the Council.

7. This Treasury Management Annual Strategy Report covers:
   - Treasury Management risk;
   - Economic and market prospects;
   - Investment and debt portfolio forecasts;
   - Borrowing and debt strategy;
   - HRA Treasury Management Strategy;
   - Investment strategy;
   - Treasury management indicators and limits on activities;
   - Treasury Management Policy Statement (Enclosure 1);
   - Approved instruments, methods and techniques (Criteria for Specified and Non-Specified Investments) (Enclosure 2).

**Treasury Management Risk**

8. The effective management of risk is a prime objective of the treasury management activities. The main risks associated with treasury management are listed below. The principal features of these risks as defined by CIPFA are set out in the Glossary of Terms (Enclosure 3).

   - Credit and counterparty Risk
   - Liquidity Risk
   - Interest Rate Risk
   - Refinancing Risk
   - Legal Risk
   - Operational Risk
   - Market Risk

9. The Council’s arrangements to manage and control treasury management risk are set out in TMP1 – Risk Management.
Economic and market prospects

10. The outlook for UK economic growth is generally optimistic. The fall in consumer price inflation from the high of 5.2% in September 2011 to 2.0% in December 2013 has helped consumers, and gives hope that it may allow real wage increases (i.e. after inflation) to slowly turn positive, improve confidence and aid future consumer spending.

11. The flow of credit to households has also improved, but the picture is somewhat mixed for lending to the corporate sector. The Bank of England’s (BoE) recent changes to the Funding for Lending Scheme (FLS) are aimed at strengthening corporate credit growth whilst moderating mortgage lending.

12. Whilst some increase in inflation is expected, it should be modest as significant spare capacity in the economy exists. With general inflation pressures set to remain subdued, and spending growth receiving support in the form of a pick-up in real income growth, the conditions for a sustained period of growth appear to be in place.

13. However, despite the relative optimism, the UK economy does continue to face substantial challenges and potential downside risks. One key risk is a weaker international environment. Possible triggers for such a development could include new worries about the banking sector in the wake of European Central Bank (ECB) stress tests. Another major risk is inflation rising strongly, if spare capacity is used up more quickly than expected, or if there is a sharp rise in international energy and commodity prices.

14. The Bank of England’s Monetary Policy Committee (MPC) through its Forward Guidance is committed to keeping policy rates low for an extended period using the Labour Force Survey unemployment rate of 7% as a threshold for when it will consider whether or not to raise interest rates, subject to certain caveats. The MPC initially forecast that the threshold would not be reached until 2016 at the earliest. However, with unemployment falling to 7.4% in November 2013, the market is pricing in a rate rise much earlier than that, although the MPC has repeatedly emphasised that the 7% threshold is not an automatic trigger for a rate rise.

15. The MPC is unlikely to raise rates until there is a sustained period of strong growth, and is therefore likely to pursue its ultra-low interest rate policy even if the unemployment rate dips below 7%. The MPC may therefore consider amending the threshold figure downwards to anchor market rate expectations.

16. The interest rate forecast provided by the Council’s treasury management advisor (Arlingclose Ltd) (Enclosure 4) is for the Bank Rate to remain flat until late 2016. The risk to the upside (i.e. rates being higher) are weighted more heavily towards the end of the forecast horizon. Gilt yields are expected to rise over the forecast period with medium and long-dated gilts expected to rise by between 0.7% and 1.1%.
### Investment and Debt portfolio forecasts

17. Investment and debt portfolio forecasts are shown in the balance sheet analysis below:

<table>
<thead>
<tr>
<th>Balance Sheet Summary projections</th>
<th>31 Mar 2014 Estimate £m</th>
<th>31 Mar 2015 Estimate £m</th>
<th>31 Mar 2016 Estimate £m</th>
<th>31 Mar 2017 Estimate £m</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Fund CFR</td>
<td>139.0</td>
<td>140.5</td>
<td>135.0</td>
<td>129.4</td>
</tr>
<tr>
<td>HRA CFR</td>
<td>130.3</td>
<td>135.6</td>
<td>135.6</td>
<td>135.6</td>
</tr>
<tr>
<td><strong>Total CFR</strong></td>
<td><strong>269.3</strong></td>
<td><strong>276.1</strong></td>
<td><strong>270.6</strong></td>
<td><strong>265.0</strong></td>
</tr>
<tr>
<td>Less External Borrowing</td>
<td>233.1</td>
<td>233.1</td>
<td>233.1</td>
<td>233.1</td>
</tr>
<tr>
<td><strong>Internal Borrowing</strong></td>
<td><strong>36.2</strong></td>
<td><strong>43.0</strong></td>
<td><strong>37.5</strong></td>
<td><strong>31.9</strong></td>
</tr>
<tr>
<td>Less usable Reserves</td>
<td>37.3</td>
<td>35.3</td>
<td>31.3</td>
<td>32.3</td>
</tr>
<tr>
<td>Less Working Capital</td>
<td>9.0</td>
<td>9.0</td>
<td>9.0</td>
<td>9.0</td>
</tr>
<tr>
<td><strong>(Net investments)</strong></td>
<td><strong>(10.1)</strong></td>
<td><strong>(1.3)</strong></td>
<td><strong>(2.8)</strong></td>
<td><strong>(9.4)</strong></td>
</tr>
</tbody>
</table>

18. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment.

19. In the past 12 months, the Council’s investment balance has ranged between £13m and £65m, and similar levels are expected to be maintained in the forthcoming year.

### Borrowing and Debt Strategy

20. The Council is currently maintaining an under-borrowed position. The capital borrowing need has not been fully funded with loan debt, as cash supporting the Council’s reserves, balances and cash flow has been used as a temporary measure. By essentially lending its own surplus funds to itself, the Council is able to minimise borrowing costs and reduce overall treasury risk by reducing the level of its external investment balances.

21. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to continue to use internal resources. Whilst such a strategy is most likely to be beneficial over the next 2-3 years as official interest rates remain low, it is unlikely to be sustained in the medium-term. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose will assist the Authority with this ‘cost of carry’ and breakeven analysis.

22. The Council’s chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Council’s long-term plans change is a secondary objective.

23. The primary source of long-term borrowing for the Council has previously been the Public Works Loan Board (PWLB), but if necessary the Council would investigate other sources of finance, such as local authority loans and bank loans, that may be available at more favourable rates. However the balance sheet forecast above, shows that the
Council does not expect to need to borrow in 2014/15, except for any unexpected cash flow shortages during the year.

24. Consideration will be given to premature repayment of debt as short term rates on investments are likely to be lower than rates paid on current debt. This would also reduce the Council’s investment balances and counterparty risk. Consideration will also be given to restructuring the debt portfolio, by prematurely repaying loans and refinancing them on similar or different terms to achieve a reduction in risk and/or savings in interest costs. However the low interest rate environment and rules regarding the premature repayment of PWLB loans adversely affects the scope to undertake meaningful debt restructuring.

25. The Council has £61m exposure to LOBO loans (Lender’s Option Borrower’s Option) which could be “called” within 2014/15. A LOBO is called when the Lender exercises its right to amend the interest rate on the loan, at which point the Council can accept the revised terms or reject them and repay the loan. Current interest rates result in very low probability of a LOBO being “called” which would trigger premature repayment, in 2014/15.

26. The Director of Finance under delegated powers may borrow in advance of need if it is within forward approved Capital Financing Requirement estimates, and if it is expected to provide the best long term value for money. Risks associated with any advance borrowing activity will be managed as part of the Council’s overall management of its treasury risks. The Council would not look to borrow more than 18 months in advance of need, although the Council is not required to link particular loans with particular items of expenditure.

**Housing Revenue Account (HRA) Treasury Management Strategy**

27. The HRA self-financing regime commenced on 1st April 2012 and the Council notionally split each of its existing long-term loans into General Fund and HRA pools at that time. Since then, long-term loans are assigned in their entirety to one pool or the other with interest payable and other costs or income arising from long-term loans being charged or credited to the respective revenue account.

28. At the start of the Self Financing regime, the HRA was required to take on £115.5m of loan debt as part of the settlement. Council officers have developed a business plan to determine how and when the Council can afford to repay the HRA debt settlement and the additional borrowing to support the Council’s housing investment programme over a 30 year period. The HRA business plan was recently refreshed and approved by Place and Sustainability Committee on 28 November 2013.

29. Differences between the value of the HRA loans pool and the HRA’s underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. Interest will be transferred between the General Fund and HRA at year end, at an internally determined rate of interest.

**Investment Strategy**

30. The Investment Strategy sets out the Council’s criteria for choosing counterparties and limiting exposure to the risk of loss. The investment strategy needs to allow for sufficient options and counterparties to be able to operate in normal market conditions. The
Council’s strategy is in accordance with CLG Investment Guidance under the Local Government Act 2003.

31. The key intention of the Guidance is to invest prudently, and to ensure that priority is given to security (protecting the capital sum from loss). Liquidity (keeping the money readily available for expenditure when needed) is secondary, followed by the yield earned on investments which is a tertiary consideration.

32. The credit risk of banking failures has diminished, but not dissipated altogether. Regulatory changes are afoot in the UK, US and Europe to move away from the bank bail-outs of previous years to bank resolution regimes in which shareholders, bond holders and unsecured creditors are ‘bailed in’ to participate in any recovery process.

33. Diversification of investments between creditworthy counterparties to mitigate bail-in risk will become even more important in the light of these developments. In order to diversify the cash portfolio, investments will be placed with approved counterparties over a range of maturity periods. Maximum investment levels with each counterparty will be set to ensure prudent diversification is achieved. Forward dealing will be undertaken if good opportunities materialise.

34. The Guidance requires certain investment policy parameters to be set within the Investment Strategy and for the Council to have regard to the CIPFA TM Code.

35. The Guidance separates investments into two categories, Specified and Non-Specified Investments. The definitions and criteria adopted to identify Specified and Non-Specified Investments are shown in Enclosure 2 for approval.

36. The Council may invest its surplus funds with any of the counterparties listed below, subject to the cash and time limits shown in paragraph 45.

- **Banks 1** – the Council will use banks (the term ‘bank’ also refers to building societies) which are:
  
  1. UK banks; and / or
  2. Non-UK and domiciled in a country which has a minimum Sovereign long term rating of AA- (or equivalent)

- **Banks 2 - UK Nationalised / part nationalised Banks** – the Council will use UK Nationalised banks and UK part nationalised banks, whose ratings fall below the criteria specified above.

- **Banks 3 – Major UK Financial Institutions** – if they fall below the criteria specified for Banks 1, the Council will continue to use the following major UK financial institutions that the Bank of England has identified for regular stress testing and which both the Bank’s Financial Policy Committee and Prudential Regulation Authority consider to be important to UK financial stability, provided that the
Council’s treasury management advisor also remain comfortable for new investments to be made:

Barclays Bank;
HSBC Group;
Lloyds Banking Group;
Nationwide Building Society;
Royal Bank of Scotland Group;
Santander UK;
Standard Chartered.

- **Banks 4 – The Council’s own banker(s)** - if the bank;
  
  (a) falls below the above criteria; and
  
  (b) is not a wholly owned bank subsidiary (see below);

  investments would be minimised in both time and monetary size.

- **Bank subsidiary and Treasury Operations** – If the entities are unrated or fall below the criteria specified above, the Council will use these where the parent bank meets the above criteria specified for Banks 1, 2, or 3.

- **UK Building Societies** – the Council will use Societies without credit ratings, where credit analysis by the Council’s treasury management advisor show them to be suitably creditworthy, and which have a profit ratio (as % of total assets) of 0.25% and above (as shown in the latest produced set of accounts). Credit analysis by Arlingclose focuses on:

  a) Solvency measures
  
  - Chance of incurring large losses
  
  - Capital resources available to cover any losses

  b) Liquidity measures
  
  - Amount of wholesale funding
  
  - Liquid assets available to cover withdrawals

- **Other credit-rated banks, organisations and securities** – whose lowest published long-term credit rating from Fitch, Moody’s and Standard & Poor’s is A- (or equivalent), provided that the Council’s treasury management advisor also remain comfortable for investments to be made.

- **UK Government** - irrespective of credit rating.

- **UK Local Authorities** - irrespective of credit rating.

- **UK Registered Providers of Social Housing** – Formerly known as Housing Associations. Registered Providers of Social Housing are tightly regulated by the Homes and Communities Agency and retain a high likelihood of receiving
government support if needed. The Authority will consider investing with unrated Registered Providers with adequate credit safeguards, however only on the specific advice of the Council’s treasury management advisor.

- **Money Market Funds** – Funds that offer same-day liquidity and aim for a constant net asset value will be used as an alternative to instant access bank accounts. Funds whose value changes with market prices and/or have a notice period will be used for longer investment periods on the specific advice of the Council’s treasury management advisor.

- **Other pooled funds** – For cash balances available for investment over the medium term. Pooled bond, equity and property funds offer enhanced returns over the longer term, but are potentially more volatile in the shorter term. They will only be used on the specific advice of the Council’s treasury management advisor.

- **Achieving for Children (AfC)** - Achieving for Children is proposed to be established as a Community Interest Company, co-owned by Kingston Council and the London Borough of Richmond upon Thames. In establishing AfC, both Councils are agreeing to provide the company with a ‘revolving credit facility’. This arrangement seeks to provide AfC with a loan facility to cover differences in timing of their income and expenditure. This loan will form part of each Council’s investment strategy.

- **Other organisations** - The Authority may consider investing with other organisations, for example by making loans to small businesses. However these would require full Council approval, following a favourable external credit assessment and on the specific advice of the Authority’s treasury management advisor.

**Credit Ratings**

37. Credit ratings are an important element of assessing credit risk. For the credit rating criteria, the Council uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council’s minimum criteria will apply to the lowest available rating for any institution, unless an investment-specific rating is available.

38. Credit rating information is supplied by the Council’s treasury advisors on all active counterparties that comply with the criteria above.

39. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made, and
- consideration will be given to the recall or sale of existing investments with the affected counterparty.

40. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided almost immediately after they occur and this information is considered before dealing.

**Use of additional information other than credit ratings**

41. Additional requirements under the Code of Practice require the Council to supplement credit rating information. Full regard will therefore be given to other available
information on the credit quality of organisations, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

**Limits applying to Investments**

42. The Council’s treasury management advisors provide specific parameters and advice in relation to investment activities. Their specific maximum counterparty, group and maturity limits, will be adhered to as far as practicable at the time of investment.

Note - General Fund and Pension Fund investments are not grouped together when considering exposure to counterparties.

- **Maturity and Monetary Limits** – Covering both Specified and Non-Specified Investments (subject to treasury managers advice – see above).

<table>
<thead>
<tr>
<th>Banks 1 and other credit rated organisations and securities</th>
<th>Fitch long term rating (or equivalent)</th>
<th>Time Limit</th>
<th>Money Limit (each)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks 1 and other credit rated organisations and securities</td>
<td>AA-</td>
<td>3 years</td>
<td>£10.0m</td>
</tr>
<tr>
<td>Banks 1 and other credit rated organisations and securities</td>
<td>A+</td>
<td>2 years</td>
<td>£7.5m</td>
</tr>
<tr>
<td>Banks 1 and other credit rated organisations and securities</td>
<td>A-</td>
<td>1 year</td>
<td>£5.0m</td>
</tr>
<tr>
<td>Banks 2</td>
<td>-</td>
<td>2 years</td>
<td>£10.0m</td>
</tr>
<tr>
<td>Banks 3</td>
<td>-</td>
<td>1 year</td>
<td>£10.0m</td>
</tr>
<tr>
<td>Banks 4</td>
<td>-</td>
<td>1 day</td>
<td>£2.5m</td>
</tr>
<tr>
<td>Bank subsidiary and Treasury Operations</td>
<td>-</td>
<td>As per parent bank</td>
<td>As per parent bank</td>
</tr>
<tr>
<td>UK Building Societies without credit ratings</td>
<td>-</td>
<td>1 year</td>
<td>£1.0m</td>
</tr>
<tr>
<td>UK Government</td>
<td>-</td>
<td>5 years</td>
<td>unlimited</td>
</tr>
<tr>
<td>UK Local Authorities</td>
<td>-</td>
<td>5 years</td>
<td>£10.0m</td>
</tr>
<tr>
<td>UK Registered Providers of Social Housing</td>
<td>A-</td>
<td>3 years</td>
<td>£10.0m</td>
</tr>
<tr>
<td>UK Registered Providers of Social Housing with credit rating lower than A- or unrated</td>
<td>-</td>
<td>1 year</td>
<td>£5.0m</td>
</tr>
<tr>
<td>Money Market Funds and other pooled funds</td>
<td>n/a</td>
<td>-</td>
<td>£10.0m</td>
</tr>
<tr>
<td>Other organisations</td>
<td>1 year</td>
<td>£1.0m</td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 years</td>
<td>£100k</td>
<td></td>
</tr>
</tbody>
</table>

- **Groups** – Any group of organisation under the same ownership or group of funds under the same management will be treated as a single organisation for limit purposes.

- **Country** – no more than £10m will be placed with any non-UK country at any time.

- **Sector** – Sector limits will be monitored regularly for appropriateness.
43. In the normal course of the council’s cash flow operations it is expected that both Specified and Non-specified investments will be utilised for the control of liquidity as both categories allow for short term investments.

44. The use of longer term instruments (greater than one year from inception to repayment) will fall in the Non-specified investment category. These instruments will only be used where the Council’s liquidity requirements are safeguarded. This will also be limited by the longer term investment limits.

45. The above criteria for choosing counterparties provide a sound approach to investment in “normal” market conditions. Subjective overlay by Members and / or officers will be considered at all times, and during exceptional market conditions the Director of Finance may temporarily restrict investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval. Similarly, time periods for investments may be restricted.

46. Examples of these restrictions would be the greater use of the Debt Management Account Deposit Facility (DMADF – a Government body which accepts local authority deposits), or with other local authorities.

Liquidity

47. To meet unexpected payments the Council seeks to maintain:

- Liquid short term deposits of at least £3m available with a week’s notice.

Use of External Fund Managers

48. The Council may use external fund managers for part of its investment portfolio. The fund managers would not be subject to the above restrictions provided that their arrangements for assessing creditworthiness and exposure limits have been risk assessed and agreed by the Director of Finance.

Treasury Management Indicators and Limits on Activity

49. The Council is required to have regard to the treasury indicators which form part of the Treasury Management Code. The purpose of these treasury indicators is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance.

50. The activity limits are:

1. Upper limits on variable interest rate exposure – This identifies a maximum limit for variable interest rates based upon the debt position net of investments.

2. Upper limits on fixed interest rate exposure – Similar to the previous indicator this covers a maximum limit on fixed interest rates.

3. Maturity structures of borrowing – These gross limits are set to reduce the Council’s exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits. (Guidance notes in the Code of Practice require LOBO loan maturity dates to be determined by the next call date).
4. Total principal funds invested for periods longer than 364 days – These limits are set with regard to the Council’s liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

51. The Council is asked to approve the following indicators:

<table>
<thead>
<tr>
<th>Interest Rate Exposures</th>
<th>2014/15</th>
<th>2015/16</th>
<th>2016/17</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>No.1</strong> Upper limit - variable rates</td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
</tr>
<tr>
<td><strong>No.2</strong> Upper limit - fixed rates</td>
<td>298</td>
<td>292</td>
<td>287</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>No.3 Maturity Structure of fixed interest rate borrowing</th>
<th>2014/15</th>
<th>2015/16</th>
<th>2016/17</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lower</td>
<td>Upper</td>
<td>Lower</td>
<td>Upper</td>
</tr>
<tr>
<td>Under 12 months</td>
<td>0%</td>
<td>50%</td>
<td>0%</td>
</tr>
<tr>
<td>12 months to 2 years</td>
<td>0%</td>
<td>50%</td>
<td>0%</td>
</tr>
<tr>
<td>2 years to 5 years</td>
<td>0%</td>
<td>50%</td>
<td>0%</td>
</tr>
<tr>
<td>5 years to 10 years</td>
<td>0%</td>
<td>70%</td>
<td>0%</td>
</tr>
<tr>
<td>10 years to 20 years</td>
<td>0%</td>
<td>70%</td>
<td>0%</td>
</tr>
<tr>
<td>20 years to 30 years</td>
<td>0%</td>
<td>70%</td>
<td>0%</td>
</tr>
<tr>
<td>30 years to 40 years</td>
<td>0%</td>
<td>70%</td>
<td>0%</td>
</tr>
<tr>
<td>40 years to 50 years</td>
<td>0%</td>
<td>70%</td>
<td>0%</td>
</tr>
<tr>
<td>50 years and above</td>
<td>0%</td>
<td>70%</td>
<td>0%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>No. 4 Maximum principal sums invested &gt;364 days</th>
<th>1 – 2 years</th>
<th>2-3 years</th>
<th>3 – 5 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principal sums invested &gt;364 days</td>
<td>40%</td>
<td>20%</td>
<td>10%</td>
</tr>
</tbody>
</table>

52. Local Treasury Management Limits - In addition to the above required activity limits, local treasury management limits have been set, based on what officers consider to be acceptable risk.

53. Fixed / Variable Interest Rate Exposures

<table>
<thead>
<tr>
<th>Limits on variable interest rates</th>
<th>2014/15</th>
<th>2015/16</th>
<th>2016/17</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt (excluding LOBO’s)</td>
<td>30</td>
<td>30</td>
<td>30</td>
</tr>
<tr>
<td>Investments (under 1 year)</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Limits on fixed interest rates</th>
<th>2014/15</th>
<th>2015/16</th>
<th>2016/17</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Investments (over 1 year)</td>
<td>40</td>
<td>40</td>
<td>40</td>
</tr>
</tbody>
</table>

54. Debt maturity repayments (excluding LOBO’s) –
- Maximum (%) of debt maturing in any one year – 20%
- Maximum (%) of debt maturing in next five years – 50%

Performance Indicators
55. The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the activity limits, which are predominantly forward looking. Examples of performance indicators often used for the treasury function are:

- Borrowing – average rate of borrowing for the year compared to average available
- Debt – average rate movement year on year
- Investments – Internal returns above the 7 day LIBID rate.

56. The results of these indicators will be reported in the Treasury Management Annual Report for 2014/15.

**Member and Officer Training**

57. The Head of Finance Strategy & Accounting and Finance Strategy Capability Lead will ensure that council members and officers tasked with treasury management responsibilities have access to training relevant to their needs.

58. Training will continue to be provided to Members as part of their induction training and on-going Member Training Programme.

59. Due to the specialist skills needed for treasury management activities, officer training will continue to cover money and capital market operations, an awareness of available sources of funds and investment opportunities, an ability to assess and control risk, and an appreciation of the implications of legal and regulatory requirements.

**TIMESCALE**

60. The Treasury Management Annual Strategy must be submitted to the Policy and Resources Committee before the beginning of each financial year and then recommended to the Council for adoption.

**FINANCIAL IMPLICATIONS**

61. Proper management of the Council’s borrowing and investment position in accordance with the approved Treasury Management Strategy contributes significantly to the financial stability of the Council’s budget position.

**LEGAL IMPLICATIONS**

62. The report fulfils two key legislative requirements. The reporting of:

- the treasury management annual strategy and treasury management indicators as required by the CIPFA Treasury Management Code of Practice; and
- the investment strategy in accordance with CLG Investment Guidance.

**RISK ASSESSMENT**

63. The Council’s arrangements to manage and control treasury management risk are set out in TMP1 – Risk Management (scrutinised by Audit Committee on 11 December 2013).
EQUALITY IMPACT ASSESSMENT IMPLICATIONS

64. An EQIA is not needed for this annual Treasury Management Strategy Report.

ENVIRONMENTAL IMPLICATIONS

65. None arising directly from this report.

Background papers held by the author of the report, Paul Godfrey, Senior Finance Analyst (Treasury), tel: 020 8547 5621 - e-mail: Paul.Godfrey@rbk.kingston.gov.uk

1. CIPFA Prudential Code for Capital Finance in Local Authorities (Revised November 2011).
2. CIPFA Treasury Management Code of Practice (Revised November 2011).
3. CLG guidance on local government investments.
4. Treasury Management Practices

LIST OF ENCLOSURES

Enclosure 1 - Treasury Management Policy Statement
Enclosure 2 - Approved Instruments, methods and techniques (Criteria for Specified and Non-Specified Investments)
Enclosure 3 - Glossary of Terms
Enclosure 4 - Interest Rate Forecast
COUNCIL’S FINANCIAL REGULATIONS

TREASURY MANAGEMENT

CIPFA CODE OF PRACTICE FOR TREASURY MANAGEMENT (Revised November 2011)

Approved by Council 29 February 2012

The Royal Borough of Kingston upon Thames adopts as part of the Council’s Financial Regulations the following four clauses of the CIPFA Code of Practice for Treasury Management and the Treasury Policy Statement as set out below:

CLAUSE 1

The Council will create and maintain, as the cornerstones for effective treasury management:

- a treasury management policy statement (see below), 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 Council 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 the Council. Such amendments will not result in the Council materially deviating from the Code’s key principles.

CLAUSE 2

The 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.

CLAUSE 3

The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Policy and Resources Committee, and for the execution and administration of treasury management decisions to the Director of Finance, who will act in accordance with the Council’s policy statement and TMPs and, if he/she is a CIPFA member, CIPFA’s Standard of Professional Practice on Treasury Management.

CLAUSE 4

The Council nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.
THE TREASURY MANAGEMENT POLICY STATEMENT (see Clause 1)

The treasury management policy statement defines the policies and objectives of the Council’s treasury management activities:

1. The Council defines its treasury management activities as:

   *The management of the Council’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. The Council 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 Council, and any financial instruments entered into to manage these risks.

3. The Council 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.

4. The Council’s specific borrowing objective is to achieve the lowest level of interest paid on debt as prudently possible, while at the same time minimising the potential volatility of the average rate of interest.

5. The Council’s specific investment objective is to achieve an overall return on total deposits above the seven day notice London Interbank Bid Rate (LIBID) – the rate at which a bank will bid to borrow money in the London money market – with the minimum risk of capital loss.
INVESTMENT STRATEGY

APPROVED INSTRUMENTS, METHODS and TECHNIQUES

1. The Council will undertake its treasury management activities by employing only those instruments, methods and techniques detailed in this schedule, and within the limits and parameters defined in the Treasury Management Annual Strategy Report.

   Approved Instruments for Investments

2. Specified Investments

   These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered by the Council to be of a "high credit quality" - low risk assets where the possibility of loss of principal or investment income is small. Specified investments are not deemed capital expenditure investments by legislation. The types of specified investments that will be used by the Council are as follows:

   - Deposits with the UK government, and Debt Management Account Deposit Facility
   - Term deposits with banks and building societies
   - Term deposits with UK local authorities
   - Certificates of deposit
   - Callable deposits
   - Money Market Funds
   - Gilts
   - Treasury Bills
   - Bonds issued by multilateral development banks
   - Sterling denominated bonds by non-UK sovereign governments
   - Local Authority Bills
   - Commercial Paper
   - Corporate Bonds
   - Investments with Registered Providers of Social Housing
   - Pooled funds

   The Council defines “high credit quality” organisations as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA- or higher. For money market funds and other pooled funds “high credit quality” is defined as those having a credit rating of A- or higher.

3. Non-Specified Investments

   Non-specified investments are any other type of investment which are not defined as Specified Investments. The authority does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by
legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown below.

<table>
<thead>
<tr>
<th>Investments in foreign countries rated below AA-</th>
<th>Max (% of portfolio)</th>
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<tr>
<td>Long-term investments</td>
<td>10</td>
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<tr>
<td>Investments without credit ratings or rated below A-</td>
<td>75</td>
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<tr>
<td><strong>Total non-specified investments</strong></td>
<td><strong>75</strong></td>
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The Director of Finance will have discretion to make non-specified investments on advice from the Council’s treasury management advisor.

4. **Approved Capital Financing Methods and Types/Sources of Funding**

**On balance sheet**
- Public Works Loans Board (PWLB) loans
- Long term money market loans, including LOBOs
- Temporary money market loans (up to 364 days)
- Bank overdraft
- Loans from bodies such as the European Investment Bank (EIB)
- Stock issues
- Finance Leases
- Deferred Purchase
- Government and EU Capital Grants
- Lottery monies
- Other Capital Grants and Contributions
- PFI/PPP

**Internal Resources**
- Capital Receipts
- Revenue Balances
- Use of Reserves

**Off balance sheet**
- Operating leases
- Structured Finance

5. **Use of Derivatives**

The use of derivatives would require separate full Council approval, and will only be considered after obtaining advice from the Council’s Treasury Management advisor, and following careful consideration whether officers have the skills and experience to identify and manage the advantages and risks associated with using derivatives.
GLOSSARY OF TREASURY TERMS

**Balances and Reserves** – Accumulated sums that are maintained either earmarked for specific future costs or commitments, or generally held to meet unforeseen or emergency expenditure.

**Bank Rate** – the official interest rate set by the Bank of England's Monetary Policy Committee and what is generally termed as the 'base rate'. Also referred to as the 'repo rate'.

**Capital Expenditure** – Expenditure on the acquisition, creation or enhancement of capital assets.

**Capital Financing Requirement (CFR)** – The Council’s underlying need to borrow for capital purposes representing the cumulative capital expenditure of the local authority that has not been financed.

**CIPFA – Chartered Institute of Public Finance and Accountancy** - one of the leading professional accountancy bodies in the UK and the only one which specialises in the public services.

**CPI** – Consumer Price Index. The UK’s main measure of inflation, used as the Bank of England’s inflation target.

**Credit Default Swap (CDS)** – Financial instrument for swapping the risk of debt default, similar to an insurance policy against a credit default.

**Credit Rating** – Formal opinion by a registered rating agency of a counterparty’s future ability to meet its financial liabilities; these are opinions only and not guarantees.

**Debt Management Office (DMO)** – An Executive Agency of Her Majesty's Treasury. The DMO's responsibilities include debt and cash management for the UK Government, lending to local authorities and managing certain public sector funds.

**Discount** – A deductible sum - calculated on normal actuarial principles – which a lender pays to the Council if a loan is repaid early and if interest rates are presently higher than the loan rate. The discount reflects the gain to the lender of foregoing the remaining instalments of interest, and receiving funds which have to be re-invested at current interest rates.

**ECB** – European Central Bank


**Financial Policy Committee** – a part of the Bank of England, responsible for identifying, monitoring and taking action to remove or reduce systemic risks with a view to protecting and enhancing the resilience of the UK financial system.

**GDP** – Gross domestic product – also referred to as ‘growth’ in the economy. The value of the national aggregate of goods and services in the economy.
Government Gilts – Gilts are issued by the UK government. They take their name from ‘gilt-edged’ being issued by the UK government. They are deemed to be very secure as the investor expects to receive the full face value of the bond to be repaid on maturity.

LOBOs (Lender’s Option / Borrowers Option) – Money Market instruments that have a fixed initial term (typically one to ten years) and then move to an arrangement whereby the lender can decide at pre-determined intervals to adjust the rate on the loan. At this stage the borrower has the option to repay the loan.

London Inter-Bank Bid Rate (LIBID) - The interest rate at which major banks in London are willing to borrow (bid for) funds from each other.

Money Market – the term applied to the institutions willing to trade in financial instruments. It is not a physical creation, but an electronic/telephonic one.

Money Market Funds – Pooled funds which invest in a range of short term assets providing high credit quality and high liquidity.

Premium – An additional sum - calculated on normal actuarial principles – which the authority pays to a lender if a loan is repaid early and if interest rates are presently lower than the loan rate. The premium reflects the loss to the lender of foregoing the remaining instalments of interest, and receiving funds which have to be re-invested at current interest rates.

Prudential Code – Developed by CIPFA and introduced in 2004 as a professional code of practice to support local authority capital investment planning within a clear, affordable, prudent and sustainable framework and in accordance with good professional practice.

Prudential Indicators – Indicators determined by the local authority to define its capital expenditure and asset management framework. They are designed to support and record local decision making in a manner that is publicly accountable; they are not intended to be comparative performance indicators.

Prudential Regulation Authority – a part of the Bank of England, responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms.

PWLB – Public Works Loan Board - an independent statutory body operated within the Debt Management Office, which is able to meet all of a local authority’s needs for long-term borrowing. The PWLB is prepared to lend to authorities who act prudently and comply with all relevant legislation.

Quantitative Easing (QE) – In the UK, it is the process used by the Bank of England to directly increase the quantity of money in the economy. It “does not involve printing more banknotes. Instead the Bank buys assets from private sector institutions – that could be insurance companies, pension funds, banks or non-financial firms – and credits the sellers’s bank account. So the seller has more money in their bank account, while their bank holds a
corresponding claim against the Bank of England (known as reserves). The end result is more money out in the wider economy”. Source: Bank of England

**RPI** – Retail Prices Index. A monthly index demonstrating the movement in the cost of living, as it tracks the prices of goods and services including mortgage interest and rent.

**RISK:**

- **Credit and counterparty risk**
  The risk of failure by a counterparty to meet its contractual obligations to the organisation under an investment, borrowing, capital, project or partnership financing, particularly as a result of the counterparty’s diminished creditworthiness, and the resulting detrimental effect on the organisation’s capital or current (revenue) resources.

- **Liquidity risk**
  The risk that cash will not be available when it is needed, that ineffective management of liquidity creates additional unbudgeted costs, and that the organisation’s business/service objectives will be thereby compromised.

- **Interest Rate risk**
  The risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the organisation’s finances, against which the organisation has failed to protect itself adequately.

- **Refinancing risk**
  The risk that maturing borrowings, capital, project or partnership financings cannot be refinanced on terms that reflect the provisions made by the organisation for those refinancings, both capital and current (revenue), and/or that the terms are inconsistent with prevailing market conditions at the time.

- **Legal Risk**
  The risk that the organisation itself, or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, and that the organisation suffers losses accordingly.

- **Operational Risk**
  The risk that an organisation fails to identify the circumstances in which it may be exposed to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings, and fails to employ suitable systems and procedures and maintain effective contingency management arrangements to these ends.

- **Market Risk**
  The risk that, through adverse market fluctuations in the value of the principal sums an organisation borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately.

**Temporary Borrowing** – Borrowing to cover peaks and troughs of cash flow, not to fund spending.
Term Deposits – Deposits of cash with terms attached relating to maturity and rate of return (interest).

Yield – The measure of the return on an investment instrument.
INTEREST RATE FORECASTS (provided by the Council’s Treasury Advisors – 19th December 2013)

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