Committee:	Special Executive	Agenda Item No.:	3
Date:	11th March 2010	Category	
Subject:	Treasury Management Strategy 2010/11	Status	Open
Report by:	Director of Resources		
Other Officers Involved:	Chief Accountant		
Director	Director of Resources		
Relevant Portfolio Holder	Councillor E. Watts, Leader of the Council		

RELEVANT CORPORATE AIMS

STRATEGIC ORGANISATIONAL DEVELOPMENT – to continually improve the efficiency and effectiveness of all Council Services by maximising the potential use of Council resources.

TARGETS

None.

VALUE FOR MONEY

The Treasury Management activities of the Council will seek to minimise the cost of borrowing and maximise the return on cash investments.

THE REPORT

This report outlines the Council's prudential indicators for 2010/11 – 2012/13 and sets out the expected treasury operations for this period. It fulfils four key legislative requirements:

- The reporting of the prudential indicators setting out the expected capital activities (as required by the CIPFA Prudential Code for Capital Finance in Local Authorities – Appendix A). The treasury management prudential indicators are now included as treasury indicators in the CIPFA Treasury Management Code of Practice;

- The Council's Minimum Revenue Provision Policy, which sets out how the Council will pay for capital assets through revenue each year (as required by Regulation under the Local Government and Public Involvement in Health Act 2007 – Also Appendix A);

- The treasury management strategy statement which sets out how the Council's treasury service will support the capital decisions taken above, the day to day treasury management and the limitations on activity through treasury prudential indicators. The key indicator is the Authorised Limit, the maximum amount of debt the Council could afford in the short term, but which would not be sustainable in the longer term. This is the Affordable Borrowing Limit required by s3 of the Local Government Act 2003. This is in accordance with the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code and shown at Appendix B;

- The investment strategy which sets out the Council's criteria for choosing investment counterparties and limiting exposure to the risk of loss. This strategy is in accordance with the Communities and Local Government (CLG) Investment Guidance and also shown in Appendix B.

Revised editions of the CIPFA Prudential Code and CIPFA Treasury Management Code of Practice were produced in November 2009. The CLG is currently consulting on changes to the Investment Guidance. The revised guidance arising from these Codes has been incorporated within these reports, with the CLG proposals being incorporated where these do not conflict with current guidance. If necessary the Investment Strategy in Appendix B will be revised if any elements of the final CLG Investment Guidance have not already been covered.

The main changes initiated in the revisions above increase Members' responsibility in this area. This would require greater Member scrutiny of the treasury policies, increased Member training and awareness and greater frequency of information.

One element of the revised CIPFA Treasury Management Code of Practice is that the clauses adopted as part of the Council's constitution be amended. This revision is shown at Annex B3 for approval. The key change is that a responsible body (committee, board or group) be responsible for ensuring effective scrutiny of the treasury management strategy and policies, before making recommendations to Council. (For this year only Executive will be the responsible body, for future years the Audit Committee will have this responsibility.)

The above policies and parameters provide an approved framework within which the officers undertake the day to day capital and treasury activities.

IMPLICATIONS

Financial:	None
Legal:	To comply with the Local Government Act 2003
Human Resources:	None

RECOMMENDATIONS

The Executive is recommended to approve each of the six elements of these reports, and recommend these to Standards Committee/Council:

1. **The prudential indicators and limits contained with Appendix A of the report.**

2. **The Minimum Revenue Provision Statement contained within Appendix A which sets out the Council's policy on Minimum Revenue Provision.**

3. **The Treasury Management Strategy 2010/11 to 2012/13, and the treasury Prudential Indicators contained within Appendix B.**

4. **The Authorised Limit Prudential Indicator.**

5. **The Investment Strategy 2010/11 contained in the treasury management strategy (Appendix B), and the detailed criteria included in Annex B1.**

6. **The revision to the Council's Constitution at Annex B3 be referred to Standards Committee for inclusion in the Council's Constitution. This revision nominates the Audit Committee to ensure effective scrutiny of the treasury management strategy and policies and this will need including in the Audit Committee's terms of reference together with changes to the functions of Executive.**

ATTACHMENTS: **N**
FILE REFERENCE: None
SOURCE DOCUMENT: Background papers held in Financial Services

Appendix A

The Capital Prudential Indicators 2010/11 – 2012/13

The Local Government Act 2003 requires the Council to adopt the CIPFA Prudential Code and produce prudential indicators. Each indicator either summarises the expected capital activity or introduces limits upon that activity, and reflects the outcome of the Council's underlying capital appraisal systems. This report updates currently approved indicators and introduces new indicators for 2012/13.

Within this overall prudential framework there is an impact on the Council's treasury management activity as it will directly impact on borrowing or investment activity. As a consequence the treasury management strategy for 2010/11 to 2012/13 is included as Appendix B to complement these indicators. Some of the prudential indicators are shown in the treasury management strategy to aid understanding.

The Capital Expenditure Plans

The Council's capital expenditure plans are summarised below and this forms the first of the prudential indicators. A certain level of capital expenditure is grant supported by the Government; any decisions by the Council to spend above this level will be considered unsupported capital expenditure. This unsupported capital expenditure needs to have regard to:

- Service objectives (e.g. strategic planning);
- Stewardship of assets (e.g. asset management planning);
- Value for money (e.g. option appraisal);
- Prudence and sustainability (e.g. implications for external borrowing and whole life costing);
- Affordability (e.g. implications for the council tax and rents);
- Practicality (e.g. the achievability of the forward plan).

The revenue consequences of capital expenditure, particularly the unsupported capital expenditure, will need to be paid for from the Council's own resources.

This capital expenditure can be paid for immediately (by applying capital resources such as capital receipts, capital grants etc. or revenue resources) but if these resources are insufficient any residual expenditure will add to the Council's borrowing need.

The key risks to the plans are that the level of Government support has been estimated and is therefore maybe subject to change. Similarly some estimates for other sources of funding, such as capital receipts, may also be subject to change over this timescale.

The Council is asked to approve the summary capital expenditure projections below. These reflect the Executive report from 4th January 2010 and the Tarrans report from 13th January 2010. This forms the first prudential indicator:

	2009/10 Revised £'000	**2010/11 Estimated £'000**	**2011/12 Estimated £'000**	**2012/13 Estimated £'000**
Capital Expenditure				
Non-HRA	6,899	3,111	349	200
HRA	4,488	4,917	3,648	3,675
Financed by:				
Capital receipts	(3,228)	(1,627)	0	0
Capital grants	(7,047)	(3,167)	(3,198)	(3,225)
Revenue	(1,048)	(1,934)	(799)	(650)
Net financing need for the year	**64**	**1,300**	**0**	**0**

The Council's Borrowing Need (the Capital Financing Requirement)
The second prudential indicator is the Council's Capital Financing Requirement (CFR). The Capital Financing Requirement is simply the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. The capital expenditure above which has not immediately been paid for will increase the Capital Financing Requirement.

The Council is asked to approve the Capital Financing Requirement projections below:

	2009/10 Revised £'000	**2010/11 Estimated £'000**	**2011/12 Estimated £'000**	**2012/13 Estimated £'000**
Capital Financing Requirement				
CFR – Non Housing	11,176	12,399	11,946	11,511
CFR - Housing	6,720	7,855	7,650	7,650
Total CFR	**17,896**	**20,254**	**19,596**	**19,161**
Movement in CFR	**3,131**	**2,358**	**(658)**	**(435)**

Movement in CFR represented by				
Net financing need for the year (from above)	64	1,300	0	0
Reversal of UCR* balance seta-side now required to finance	3,377	1,462	(205)	0
MRP and other financing movements	(310)	(404)	(453)	(435)
Movement in CFR	**3,131**	**2,358**	**(658)**	**(435)**

*Useable Capital Receipts

The Council is required to pay off an element of the accumulated General Fund capital spend each year through a revenue charge (the Minimum Revenue Provision), although it is also allowed to undertake additional voluntary payments.

CLG Regulations have been issued which require full Council to approve a Minimum Revenue Provision Statement in advance of each year. A variety of options are provided to councils to replace the existing Regulations, so long as there is a prudent provision.

The Council is recommended to approve the following Minimum Revenue Provision Statement:

For capital expenditure incurred before 1 April 2008 or which in the future will be supported capital expenditure the Minimum Revenue Provision policy will be:

- **Existing practice** - Minimum Revenue Provision will follow the existing practice outlined in former CLG Regulations (Option 1), capital financing requirement minus "adjustment A" multiplied by 4%.

From 1 April 2008 for all unsupported borrowing the Minimum Revenue Provision policy will be:

- **Asset Life Method** - Minimum Revenue Provision will be based on the estimated life of the assets, in accordance with the proposed regulations (Option 3).

In the case of finance leases (either existing or those operating leases that come on balance sheet as a result of International Financial Reporting Standards) the Minimum Revenue Provision would be regarded as met by a charge equal to the element of the charge that goes to write down the balance sheet liability. Thus Option 3 will apply in a modified form.

The Use of the Council's Resources and the Investment Position

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.).

Affordability Prudential Indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

1) Actual and Estimates of the ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (interest on borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2009/10 Revised	2010/11 Estimated	2011/12 Estimated	2012/13 Estimated
Non-HRA	4.93%	5.55%	6.13%	4.48%
HRA	17.38%	22.90%	22.56%	22.03%

The estimates of financing costs include current commitments and the proposed Capital Programme.

2) Estimates of the incremental impact of capital investment decisions on the Council Tax

This indicator identifies the revenue costs associated with proposed changes to the three year capital programme. As no new general fund schemes financed by borrowing were recommended in respect of 2010/11 budget bids the indicator is not required this year.

	2009/10 Revised	2010/11 Estimated	2011/12 Estimated	2012/13 Estimated
Band D Council Tax	£0.00	£0.00	£0.00	£0.00

3) Estimates of the incremental impact of capital investment decisions on Housing Rent levels

Similar to the Council tax calculation this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in the budget report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

	2009/10 Revised	2010/11 Estimated	2011/12 Estimated	2012/13 Estimated
Weekly Housing Rent levels	£0.00	£0.08	£0.16	£0.16

Appendix B

Treasury Management Strategy 2010/11 – 2012/13

The treasury management service is an important part of the overall financial management of the Council's affairs. The prudential indicators in Appendix A consider the affordability and impact of capital expenditure decisions and set out the Council's overall capital framework. The treasury service considers the effective funding of these decisions. Together they form part of the process which ensures the Council meets its balanced budget requirement under the Local Government Finance Act 1992.

The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management – revised November 2009). This Council adopted the Code of Practice on Treasury Management on 1st March 2002 and will adopt the revised Code.

As a result of adopting the Code the Council also adopted a Treasury Management Policy Statement (1st March 2002). This adoption is the requirement of one of the prudential indicators. One element of the revised CIPFA Treasury Management Code of Practice is that the clauses adopted as part of the Council's constitution be amended. This revision is shown at Annex B3 for approval.

The Constitution requires an annual strategy to be reported to Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. A further treasury report is produced after the year-end to report on actual activity for the year, and a new requirement of the revision of the Code of Practice is that there is a mid-year monitoring report.

This strategy covers:

- The Council's debt and investment projections;
- The Council's estimates and limits on future debt levels;
- The expected movement in interest rates;
- The Council's borrowing and investment strategies;
- Treasury performance indicators;
- Specific limits on treasury activities;

Debt and Investment Projections 2010/11 – 2012/13

The borrowing requirement comprises the expected movement in the Capital Financing Requirement and any maturing debt which will need to be re-financed. The table below shows this effect on the treasury position over the next three years. The expected maximum debt position during each year represents the Operational Boundary prudential indicator and so may be different from the year end position. The table also highlights the expected change in investment balances.

	2009/10 Revised £'000	2010/11 Estimated £'000	2011/12 Estimated £'000	2012/13 Estimated £'000
External Debt				
Debt at 1 April	19,100	19,100	20,400	20,400
Expected change in debt	0	1,300	0	0
Debt at 31 March	19,100	20,400	20,400	20,400
Investments				
Total Investments at 31 March	13,727	11,452	11,452	11,452
Investment change between years	(83)	(2,275)	0	0

The related impacts of the above movements on the revenue budget are:

	2009/10 Revised £'000	2010/11 Estimated £'000	2011/12 Estimated £'000	2012/13 Estimated £'000
Revenue Budgets				
General Fund Interest	711	1,047	1,108	1,108
HRA Interest Charge	303	342	333	328
Total Interest Cost on Borrowing	**1,014**	**1,389**	**1,441**	**1,436**
Investment income	(227)	(250)	(283)	(565)

Limits to Borrowing Activity

Within the prudential indicators there are a number of key indicators to ensure the Council operates its activities within well defined limits.

For the first of these the Council needs to ensure that its total borrowing net of any investments, does not, except in the short term, exceed the total of the Capital Financing Requirement in the preceding year plus the estimates of any additional Capital Financing Requirement for 2010/11 and the following two financial years (the relevant comparative figures are highlighted). This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

	2009/10 Revised £'000	2010/11 Estimated £'000	2011/12 Estimated £'000	2012/13 Estimated £'000
Gross Borrowing	19,100	20,400	20,400	20,400
Investments	(13,727)	(11,452)	(11,452)	(11,452)
Net Borrowing	**5,373**	**8,948**	**8,948**	**8,948**
CFR	17,896	20,254	19,596	19,161

The Director of Resources reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans and proposals to the capital programme.

The Authorised Limit for External Debt - A further key prudential indicator represents a control on the overall level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by Full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although no control has yet been exercised.

The Council is asked to approve the following Authorised Limit:

Authorised limit	**2009/10 Revised £'000**	**2010/11 Estimated £'000**	**2011/12 Estimated £'000**	**2012/13 Estimated £'000**
Limit for Borrowing	29,100	30,400	30,400	30,400
Other long term liabilities	0	0	0	0
Total	29,100	30,400	30,400	30,400
Operational Boundary				
Limit for Borrowing	19,100	20,400	20,400	20,400
Other long term liabilities	0	0	0	0
Total	19,100	20,400	20,400	20,400

Borrowing in advance of need – The Council has some flexibility to borrow funds this year for use in future years. The Director of Resources may do this under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. Whilst the Director of Resources will adopt a cautious approach to any such borrowing, where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities.

Risks associated with any advance borrowing activity will be subject to appraisal in advance and subsequent reporting through the mid-year or annual reporting mechanism. It is very unlikely that borrowing in advance of need will take place during the next financial year.

Expected Movement in Interest Rates

Medium-Term Rate Estimates (averages)

Year	**Bank Rate %**	**Money Rates %**	**%**	**PWLB Rates * %**	**%**	**%**
		3 month	**1 year**	**5 year**	**20 year**	**50 year**
2009/10	0.5	.8	1.4	3.2	4.4	4.6
2010/11	1.0	1.5	2.3	4.0	5.0	5.2
2011/12	2.0	2.5	3.3	4.3	5.3	5.3
2012/13	4.5	4.8	5.3	5.3	5.5	5.3

* Borrowing Rates

Short-term rates are expected to remain on hold for a considerable time. The recovery in the economy has commenced but it will remain insipid and there is a danger that early reversal of monetary ease, (rate cuts and Quantative Easing {QE}), could trigger a dip back to negative growth and a W-shaped GDP path.

Credit extension to the corporate and personal sectors has improved modestly but banks remain nervous about the viability of counterparties. This is likely to remain a drag upon activity prospects, as will the lacklustre growth of broad money supply.

The main drag upon the economy is expected to be weak consumers' expenditure growth. The combination of the desire to reduce the level of personal debt and job uncertainty is likely to weigh heavily upon spending. This will be amplified by the prospective increases in taxation already scheduled for 2010 – VAT and National Insurance. Without a rebound in this key element of UK GDP growth, any recovery in the economy is set to be weak and protracted.

The Monetary Policy Committee (MPC) will continue to promote easy credit conditions via quantitative monetary measures. QE has been extended to a total of £200bn and there is still an outside chance that it could be expanded further in February. Whether this has much impact in the near term remains a moot point given the personal sector's reluctance to take on more debt and add to its already unhealthy balance sheet.

With inflation set to remain subdued in the next few years (though a sharp blip is forecast for the next few months), the pressure upon the MPC to hike rates will remain moderate. But some increase will be seen as necessary in 2010 to counter the effects of external cost pressures (as commodity price strength filters through) and to avoid damage that sterling could endure if the UK is seen to defy an international move to commence policy exit strategies.

The outlook for long-term fixed interest rates is a lot less favourable. While the UK's fiscal burden should ease in the future, this will be a lengthy process and deficits over the next two to three financial years will require a very heavy programme of gilt issuance. The market will no longer be able to rely upon Quantitative Easing to alleviate this enormous burden.

The programme might well end in February, especially if the economy has returned to a recovery path as seems very likely. With growth back on the agenda and inflation challenging the upper limit of the Government's target range, the majority of MPC members may feel enough assistance has been given to ensure lack of credit is no longer a fundamental threat to the welfare of the economy

The absence of the Bank of England as the largest buyer of gilts will shift the balance between supply and demand in the gilt-edged market. Other investors will almost certainly require some incentive to continue buying government paper.

This incentive will take the form of higher interest rates. The longer fixed interest rates will suffer from the lack of support from the major savings institutions – pension funds and insurance companies who will continue to favour other investment instruments as a source of value and performance. The shorter fixed interest rates will be pressured higher by the impact of rising money market rates. While bank purchases in this part of the market will continue to feature as these institutions meet regulatory obligations, this process will be insufficiently strong to resist the upward trend in yields.

The Bank Base Rate is currently 0.5%.

Borrowing Strategy 2010/11 – 2012/13

The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy.

Long-term fixed interest rates are at risk of being higher over the medium term and short term rates are expected to rise, although more modestly. The Director of Resources, under delegated powers, will take the most appropriate form of borrowing, if necessary, depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above. It is likely that shorter term fixed rates may provide lower cost opportunities in the short/medium term.

With the likelihood of long term rates increasing any debt restructuring is likely to focus on switching from longer term fixed rates to cheaper shorter term debt, if after premia a revenue saving results. The Director of Resources and treasury consultants will monitor prevailing rates for any opportunities during the year.

The option of postponing borrowing and running down investment balances will also be considered. This would reduce counterparty risk and hedge against the expected fall in investment returns.

Investment Strategy 2010/11 – 2012/13

Key Objectives - The Council's investment strategy primary objectives are safeguarding the re-payment of the principal and interest of its investments on time first and ensuring adequate liquidity second – the investment return being a third objective. Following the economic background above, the current investment climate has one over-riding risk consideration, that of counterparty security risk. As a result of these underlying concerns officers are implementing an operational investment strategy which tightens the controls already in place in the approved investment strategy.

Risk Benchmarking – A development in the revised Codes and the CLG consultation paper is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are new requirements to the Member reporting, although the application of these is more subjective in nature. Additional background in the approach taken is attached at Annex B2.

These benchmarks are simple targets (not limits) and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy depending on any changes. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

Security - The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

- **0.01**% historic risk of default when compared to the whole portfolio.

Liquidity – In respect of this area the Council seeks to maintain:

- Bank overdraft - £250,000
- Liquid short term deposits of at least £3m available with a week's notice.
- Weighted Average Life benchmark is expected to be 0.5 years, with a maximum of 0.7 years.

Yield - Local measures of yield benchmarks are :

- Investments – Internal returns above the 7 day LIBID rate

And in addition that the security benchmark for each individual year is:

	1 year	2 years	3 years	4 years	5 years
Maximum	**0.01%**	**0**	**0**	**0**	**0**

Note: This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment.

Investment Counterparty Selection Criteria - The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Council will ensure:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections below.

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

The Director of Resources will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. This criteria is separate to that which chooses Specified and Non-Specified investments as it provides an overall pool of counterparties considered high quality the Council may use rather than defining what its investments are.

The rating criteria use 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. For instance if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria. This is in compliance with a CIPFA Treasury Management Panel recommendation in March 2009 and the CIPFA Treasury Management Code of Practice.

Credit rating information is supplied by our treasury consultants on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance a negative rating watch applying to a counterparty will be suspended from use.

The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) is:

- **Banks 1 – Good Credit Quality** - the Council will only use banks which:
    1. Are UK banks; and/or
    2. Are non-UK and domiciled in a country which has a minimum Sovereign long term rating of AA+

And have, as a minimum, the following Fitch, Moody's and Standard and Poor's ratings (where rated):

- **Short Term** – F1 or equivalent from Fitch, Moody's or Standard + Poor's
- **Long Term** – A or equivalent from Fitch, Moody's or Standard + Poor's
- **Individual / Financial Strength** – C from Fitch or Moody's
- **Support** – 3 from Fitch only

- **Banks 2 – Guaranteed Banks with suitable Sovereign Support** – In addition, the Council will use banks whose ratings fall below the criteria specified above if all of the following conditions are met:
  - (a) wholesale deposits in the bank are covered by a government guarantee;
  - (b) the government providing the guarantee is rated "AAA" by all three major rating agencies (Fitch, Moody's and Standard & Poors); and
  - (c) the Council's investments with the bank are limited to amounts and maturities within the terms of the stipulated guarantee.
- **Banks 3 – Eligible Institutions** - the organisation is an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008. These institutions have been subject to suitability checks before inclusion, and have access to HM Treasury liquidity if needed. Organisations will only be included where they meet the short term and long term ratings for Banks 1 above.
- **Banks 4** – The Council's own banker if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- **Bank Subsidiary and Treasury Operations** – the Council will use these where the parent bank has the necessary ratings outlined above.
- **Building Societies** – the Council will *use* all Societies which:
  - meet the ratings for banks outlined above

  Or are :

  - Eligible Institutions
- **Money Market Funds** – *AAA*
- **UK Government** (including gilts and the DMADF)
- **Local Authorities, Parish Councils etc**
- **Supranational institutions**

A limit of £3m will be applied to the use of Non-Specified investments.

Country and sector considerations - Due care will be taken to consider the country, group and sector exposure of the Council's investments. In part the country selection will be chosen by the credit rating of the Sovereign state in Banks 1 above. In addition:

- no more than 20% will be placed with any non-UK country at any time;
- limits in place above will apply to Group companies;
- Sector limits will be monitored regularly for appropriateness.

Use of additional information other than credit ratings – Additional requirements under the Code of Practice now require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

Time and Monetary Limits applying to Investments - The time and monetary limits for institutions on the Council's Counterparty List are as follows (these will cover both Specified and Non-Specified Investments):

	Fitch (or equivalent)	Money Limit	Time Limit
Upper Limit	F1+ AA- or better	£5m	3 years
Lower Limit	F1 A or better	£5m	1 year
Other Institution Limits	AAA	£3m	3 years

The proposed criteria for Specified and Non-Specified investments are shown in Annex B1 for approval.

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.

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.

Economic Investment Considerations - Expectations on shorter-term interest rates, on which investment decisions are based, show likelihood of the current 0.5% Bank Rate remaining flat but with the possibility of a rise in mid-2010. The Council's investment decisions are based on comparisons between the rises priced into market rates against the Council's and advisers own forecasts.

There is an operational difficulty arising from the current banking crisis. There is currently little value investing longer term unless credit quality is reduced. Whilst some selective options do provide additional yield uncertainty over counterparty creditworthiness suggests shorter dated investments would provide better security.

The criteria for choosing counterparties set out above provide a sound approach to investment in "normal" market circumstances. Whilst Members are asked to approve this base criteria above, under the exceptional current market conditions the Director of Resources may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval. These restrictions will remain in place until the banking system returns to "normal" conditions. Similarly the time periods for investments will be restricted.

Examples of these restrictions would be the greater use of the Debt Management Deposit Account Facility (DMADF – a Government body which accepts local authority deposits), Money Market Funds, guaranteed deposit facilities and strongly rated institutions offered support by the UK Government. The credit criteria have been amended to reflect these facilities.

Sensitivity to Interest Rate Movements

Future Council accounts will be required to disclose the impact of risks on the Council's treasury management activity. Whilst most of the risks facing the treasury management service are addressed elsewhere in this report (credit risk, liquidity risk, market risk, maturity profile risk), the impact of interest rate risk is discussed but not quantified.   The table below highlights the estimated impact of a 1% increase/decrease in all interest rates to the estimated treasury management costs/income for next year. That element of the debt and investment portfolios which are of a longer term, fixed interest rate nature will not be affected by interest rate changes.

	2010/11 Estimated + 1%	2010/11 Estimated - 1%
HRA Investment Interest	8	-8
GF Investment income	118	-118

Treasury Management Limits on Activity

There are four further treasury activity limits, which were previously prudential indicators. The purpose of these are 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. The indicators are:

- Upper limits on variable interest rate exposure – This identifies a maximum limit for variable interest rates based upon the debt position net of investments.
- Upper limits on fixed interest rate exposure – Similar to the previous indicator this covers a maximum limit on fixed interest rates.
- 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.
- Total principal funds invested for greater 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.

The Council is asked to approve the limits:

£m	2010/11	2011/12	2012/13
Interest rate Exposures			
	Upper	Upper	Upper
Limits on fixed interest rates based on net debt	95%	95%	95%
Limits on fixed interest rates: • Debt only • Investments only	 100% 95%	 100% 95%	 100% 95%
Maturity Structure of fixed interest rate borrowing 2010/11			
		Lower	Upper
Under 12 months		0%	20%
12 months to 2 years		0%	40%
2 years to 5 years		0%	60%
5 years to 10 years		0%	80%
10 years and above		0%	100%
Maximum principal sums invested > 364 days			
Principal sums invested > 364 days	£3m	£3m	£3m

Performance Indicators

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 prudential indicators, which are predominantly forward looking. Examples of performance indicators often used for the treasury function are:

- Debt – 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

The results of these indicators will be reported in the Treasury Annual Report.

Treasury Management Advisers

The Council uses Butlers as its treasury management consultants. The company provides a range of services which include:

- Technical support on treasury matters, capital finance issues and the drafting of Member reports;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments;
- Credit ratings/market information service comprising the three main credit rating agencies;

Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice the final decision on treasury matters remains with the Council. This service is subject to regular review.

Member and Officer Training

The increased Member consideration of treasury management matters and the need to ensure officers dealing with treasury management are trained and kept up to date requires a suitable training process for Members and officers. This Council has addressed this important issue by:

a. An annual training event for those charged with monitoring and scrutinising treasury management, by the Council's advisers Butlers.
b. Members' individual needs are to be addressed by personal development plans.
c. Officers attend training seminars held by Butlers.
d. Officers have at least two annual strategy meetings with Butlers to discuss recent issues.
e. Monthly, officer treasury management strategy meeting to discuss new developments/procedures.

Local Issues

Iceland Investments – The Council is currently working with the Local Government Association to recover as much of the £3m investment with Landsbanki as possible. CIPFA guidance is being followed to prepare the Medium Term Financial Plan and Statement of Accounts.

Annex B1

Treasury Management Practice (TMP) 1 – Credit and Counterparty Risk Management

The Office of the Deputy Prime Minister (now CLG) issued Investment Guidance on 12th March 2004, and this forms the structure of the Council's policy below. The CLG is currently consulting over revisions to the Guidance and where applicable the Consultation recommendations have been included within this policy. These guidelines do not apply to either trust funds or pension funds which are under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for Councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the Code on 1st March 2002 and will apply its principles to all investment activity. In accordance with the Code, the Director of Resources has produced the treasury management practices (TMPs). This part, TMP 1(5), covering investment counterparty policy requires approval each year.

Annual Investment Strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of the following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Council is:

Strategy Guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

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 low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.
3. A local authority, parish council or community council.
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's or Fitch rating agencies.
5. A body that is considered of a high credit quality (such as a bank or building society. For category 5 this covers bodies with a minimum short term rating of F1 (or the equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies.
6. Eligible institutions subject to limits as for Banks 1.

Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies. This criteria is F1+ institutions £5m for 3 years; F1 institutions £5m and 1 year; Other institution limits AAA £3m for 3 year.

Non-Specified Investments – Non-specified investments are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investments would include any sterling investments with:

	Non Specified Investment Category	Limit (£ or %)
a.	Supranational Bonds greater than 1 year to maturity (a) Multilateral development bank bonds - These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Investment Bank etc.). (b) A financial institution that is guaranteed by the United Kingdom Government (e.g. The Guaranteed Export Finance Company {GEFCO}) The security of interest and principal on maturity is on a par with the Government and so very secure, and these bonds usually provide returns above equivalent gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	AAA long term ratings
b.	Gilt edged securities with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may	Zero – not using

	accrue if the bond is sold before maturity.	
	Non Specified Investment Category	Limit (£ or %)
c.	Eligible Institutions – the organisation is an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on the 13 October 2008, with the necessary short and long term ratings required in Banks 1 above. These institutions have been subject to suitability checks before inclusion, and have access to HM Treasury liquidity if needed.	Limit as for Banks 1
d.	The Council's own banker if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.	£1m
e.	Building societies not meeting the basic security requirements under the specified investments. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The Council may use such building societies which are Eligible Institutions but will restrict these type of investments.	Zero – not using
f.	Any bank or building society that has a minimum long term credit rating of F1+, for deposits with a maturity of greater than one year.	Zero – not using
g.	Any non rated subsidiary of a credit rated institution included in the specified investment category.	Zero – not using
h.	Share capital or loan capital* in a body corporate – The use of these instruments will be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. Revenue resources will not be invested in corporate bodies. There is a higher risk of loss with these types of instruments	Zero – not using
i.	Pooled property or bond funds* – The use of these instruments will normally be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. Revenue resources will not be invested in corporate bodies.	Zero – not using

Within categories c, d and f, and in accordance with the Code, the Council has developed additional criteria to set the overall amount of monies which will be invested in these bodies. The bodies must still have access to the Governments financial rescue package covering the period of investment.

In respect of categories g and h, these will only be considered after obtaining external advice and subsequent Member approval.

The Monitoring of Investment Counterparties - The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Butlers as and when ratings change, and counterparties are checked promptly.

On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Director of Resources, and if required new counterparties which meet the criteria will be added to the list.

Security, Liquidity and Yield Benchmarking

Benchmarking and Monitoring Security, Liquidity and Yield in the Investment Service - A proposed development for Member reporting is the consideration and approval of security and liquidity benchmarks.

These benchmarks are targets and so may be breached from time to time. Any breach will be reported, with supporting reasons in the Annual Treasury Report.

Yield – These benchmarks are currently widely used to assess investment performance. Local measures of yield benchmarks are:

- Investments – Internal returns above the 7 day LIBID rate

Security and liquidity benchmarks are already intrinsic to the approved treasury strategy through the counterparty selection criteria and some of the prudential indicators. However they have not previously been separately and explicitly set out for Member consideration. Proposed benchmarks for the cash type investments are below and these will form the basis of future reporting in this area. In the other investment categories appropriate benchmarks will be used where available.

Liquidity – This is defined as "having adequate, though not excessive cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives" (CIPFA Treasury Management Code of Practice). In respect of this area the Council seeks to maintain:

- Bank overdraft - £250,000
- Liquid short term deposits of at least £3m available with a week's notice.

The availability of liquidity and the term risk in the portfolio can be benchmarked by the monitoring of the Weighted Average Life (WAL) of the portfolio – shorter WAl would generally embody less risk. In this respect the proposed benchmark is to be used:

- WAL benchmark is expected to be 0.5 years, with a maximum of 0.7 years.

Security of the investments – In context of benchmarking, assessing security is a much more subjective area to assess. Security is currently evidenced by the application of minimum credit quality criteria to investment counterparties, primarily through the use of credit ratings supplied by the three main credit rating agencies (Fitch, Moody's and Standard and Poors). Whilst this approach embodies security considerations, benchmarking levels of risk is more problematic. One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council's investment strategy. The table overleaf shows average defaults for differing periods of investment grade products for each Fitch long term rating category over the period 1990 to 2007.

Long term rating	1 year	2 years	3 years	4 years	5 years
AAA	0.00%	0.00%	0.00%	0.00%	0.00%
AA	0.00%	0.00%	0.00%	0.03%	0.06%
A	0.03%	0.15%	0.30%	0.44%	0.65%
BBB	0.24%	0.78%	1.48%	2.24%	3.11%

The Council's minimum long term rating criteria is currently “A”, meaning the average expectation of default for a one year investment in a counterparty with a “A” long term rating would be 0.03% of the total investment (e.g. for a £1m investment the average loss would be £300). This is only an average - any specific counterparty loss is likely to be higher - but these figures do act as a proxy benchmark for risk across the portfolio.

The Council's maximum security risk benchmark for the whole portfolio, when compared to these historic default tables, is:

- 0.01% historic risk of default when compared to the whole portfolio.

And in addition that the security benchmark for each individual year is:

	1 year	2 years	3 years	4 years	5 years
Maximum	0.01%	0	0	0	0

These benchmarks are embodied in the criteria for selecting cash investment counterparties and these will be monitored and reported to Members in the Investment Annual Report. As this data is collated, trends and analysis will be collected and reported. Where a counterparty is not credit rated a proxy rating will be applied.

Annex B3

Treasury Management Clauses to form part of Constitution

1. This Council 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 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.
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.
3. The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to the Executive and for the execution and administration of treasury management decisions to the Head of Finance and Revenues/Director Of Resources, who will act in accordance with the Council's policy statement and TMPs and CIPFA's Standard of Professional Practice on Treasury Management.
4. The organisation nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.