

### Treasury Management Strategy Report 2012/13

This report outlines the Council's prudential indicators for 2012/13 – 2014/15 and sets out the expected treasury operations for this period. It fulfils four key legislative requirements as required by the Local Government Act 2003:

- 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. The treasury management prudential indicators are now included as treasury indicators in the CIPFA Treasury Code of Practice (section 1);
- The Council's Minimum Revenue Provision (MRP) 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 (section 1);
- 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 in section 2;
- The investment strategy which sets out the Council's criteria for choosing investment counterparties and limiting exposure to the risk of loss (in accordance with the CLG (Communities for Local Government) investment guidance) (section 3);

Revised editions of the CLG Investment Guidance (March 2010) and the CIPFA Prudential Code and CIPFA Treasury Management Code of Practice were produced in November 2011. The revised guidance arising from these have been incorporated within this report.

The main changes initiated in the revisions above increase the Members' responsibility in this area. This requires greater Member scrutiny of the treasury policies, increased Member training and awareness and greater frequency of information. The Council has already incorporated these changes within its constitution by delegating responsibility for monitoring and revisions to the Treasury Management Strategy to Governance and Audit Committee. In addition to this the committee has undertaken specific Treasury Management training in June 2011. A mid-year report on performance in conjunction with an annual report is presented to the Governance and Audit Committee.

**SECTION 1 - THE PRUDENTIAL INDICATORS 2011/12 to 2014/15**

**Introduction**

1. The Local Government Act 2003 requires the Council to adopt the CIPFA Prudential Code and produce prudential indicators. In addition to this the Council also adopts CIPFA's Treasury Management in the Public Services: code of practice and cross-sectoral guidance notes. This report revises the indicators for 2011/12 and 2012/13, and introduces new indicators for 2013/14 and 2014/15. Each indicator either summarises the expected activity or introduces limits upon the activity, and reflects the outcome of the Council's underlying capital appraisal systems.
2. Within this overall prudential framework there is a clear impact on the Council's treasury management activity, either through borrowing or investment activity. As a consequence the treasury management strategy for 2012/13 is included in Section 2 to complement the indicators, and this report includes the prudential indicators relating to the treasury activity.
3. A number of Prudential Indicators covering treasury management have been moved to the Treasury Management Code of Practice. These Treasury Management indicators are contained within this report.
4. A key issue facing the Council is the impact of the planned HRA reform which essentially brings to an end the housing subsidy system and will see the HRA become a standalone business. The Council currently pays into the HRA subsidy system and in order to stop future payments from the 1 April 2012 the Council is required to pay the CLG £122m. The payment is effectively HRA debt, and so the prudential indicators have been adjusted to reflect this change (as approved by Council on 8<sup>th</sup> December 2011). The actual payment will be made on the 28 March 2012 and the change is expected to be beneficial to the Council.

**The Capital Expenditure Plans**

5. 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).
6. The revenue consequences of capital expenditure, particularly the unsupported capital expenditure, will need to be paid for from the Council's own resources.

7. 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 capital expenditure will add to the Council's borrowing need. Each year an annual revenue charge (Minimum Revenue Provision) to reduce the borrowing need.
8. 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 of estimates for other sources of funding, such as capital receipts, may also be subject to change over this timescale. For instance anticipated asset sales may be postponed due to impact of the recession on the property market.
9. The Council is asked to approve the summary capital expenditure projections below. This forms the first prudential indicator:

£m	2011/12 Revised £	2012/13 Estimated £	2013/14 Estimated £	2014/15 Estimated £
Capital Expenditure				
Non-HRA	£2.337m	£6.477m	£3.011m	£2.114m
HRA	£5.410m	£4.411m	£3.809m	£4.707m
Financed by:				
Supported Borrowing	£0.000m	£0.000m	£0.000m	£0.000m
Unsupported Borrowing	£0.000m	£0.000m	£0.000m	£0.000m
Capital receipts reserve	£0.000m	£4.752m	£2.232m	£1.335m
Capital grants	£0.569m	£0.654m	£0.254m	£0.254m
Capital reserves	£6.653m	£4.798m	£3.809m	£4.707m
Revenue	£0.525m	£0.684m	£0.525m	£0.525m
Net financing need for the year	0	0	0	0

### **The Council's Borrowing Need (the Capital Financing Requirement)**

10. The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR 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 Council's underlying borrowing need. The capital expenditure above which has not immediately been paid for will increase the CFR.
11. Following accounting changes the CFR includes any other long term liabilities (e.g. PFI schemes, finance leases) brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has no such schemes within the CFR

12. The Council is asked to approve the CFR projections below:

£m	2011/12 Revised £	2012/13 Estimated £	2013/14 Estimated £	2014/15 Estimated £
<b>Capital Financing Requirement</b>				
CFR – Non Housing	4.663m	4.476m	4.297m	4.125m
CFR - Housing	2.159m	124.480m	124.480m	124.480m
HRA Settlement	122.321m	0.000m	0.000m	0.000m
Total CFR	129.143m	128.956m	128.777m	128.605m
Movement in CFR	122.127m	(0.187m)	(0.179m)	(0.172m)

£m	2011/12 Revised £	2012/13 Estimated £	2013/14 Estimated £	2014/15 Estimated £
<b>Movement in CFR represented by</b>				
Net Financing need for the year (above)	0.000m	0.000m	0.000m	0.000m
HRA Settlement	122.321m	0.000m	0.000m	0.000m
Less MRP/VRP and other financing movements	(0.194m)	(0.187m)	(0.179m)	(0.172m)
Movement in CFR	122.127m	(0.187m)	(0.179m)	(0.172m)

13. 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 - MRP), although it is also allowed to undertake additional voluntary payments (VRP). The MRP is the reason for the negative year on year movements in the CFR forecasts shown above.

14. CLG Regulations have been issued which require full Council to approve an MRP 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 MRP Statement.

15. For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

- **Existing practice** - MRP will follow the existing practice outline in former CLG Regulations.

16. From 1 April 2008 for all new unsupported borrowing the MRP policy will be:

- **Asset Life Method** – MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Directive).

17. For authorities who participate in LAMS (Local Authority Mortgage Scheme) using the cash backed option (which the Council is currently considering), the mortgage lenders require a 5 year deposit from the local authority to match the 5 year life of the indemnity. The deposit placed with the mortgage lender provides an integral part of the mortgage lending, and is treated as capital expenditure and a loan to a third party. The Capital Financing Requirement (CFR) will increase by the amount of the total indemnity. The deposit is due to be returned in full at maturity, with interest paid either annually or on maturity. Once the deposit matures and funds are returned to the local authority, the returned funds are classed as a capital receipt, and the CFR will reduce accordingly. As this is a temporary (5 year) arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application.
18. No revenue charge is currently required for the HRA. However under HRA reform the HRA will be required to charge depreciation on its assets, which will have a revenue effect. In order to address any possible adverse impact, regulations will allow the Major Repairs Allowance to be used as a proxy for depreciation for the first five years.
19. Repayments included in annual PFI or finance leases are applied as MRP

**The Use of the Council’s resources and the Investment Position**

20. 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.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources £m	2011/12 Revised £	2012/13 Estimated £	2013/14 Estimated £	2014/15 Estimated £
Fund balances	11.398m	12.084m	14.219m	16.976m
Capital receipts	8.280m	4.668m	4.663m	4.555m
HRA reserve	8.482m	8.554m	10.009m	13.086m
Major Repairs Reserve	3.611m	4.400m	5.791m	6.284m
<b>Total Core Funds</b>	<b>31.771m</b>	<b>29.706m</b>	<b>34.652m</b>	<b>40.901m</b>
Working Capital*	(2.370m)	(2.370m)	(2.370m)	(2.370m)
Expected Investments	<b>29.401m</b>	<b>27.336m</b>	<b>32.282m</b>	<b>38.531m</b>

\* Working capital balances shown are estimated year end; these may be higher mid year

**Affordability Prudential Indicators**

21. 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 overall Council's finances. The Council is asked to approve the following indicators:

22. **Actual and Estimates of the ratio of financing costs to net revenue stream** – This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	2011/12 Revised	2012/13 Estimated	2013/14 Estimated	2014/15 Estimated
Non-HRA	(0.51%)	(1.04%)	(1.21%)	(3.24%)
HRA	(0.60%)	20.95%	19.87%	24.24%

23. The estimates of financing costs include current commitments and the proposals in this budget report.

24. **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 recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of government support, which are not published over a three year period.

25. **Incremental impact of capital investment decisions on the Band D Council Tax**

£	Original 2011/12	Forward Projection 2012/13	Forward Projection 2013/14	Forward Projection 2014/15
Variance change in original to revised spending programme	-1.44	1.58	0.76	0.51

26. **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 this budget report compared to the Council's existing commitments and current plans, expressed as a discrete impact on housing stock.

27. **Incremental impact of capital investment decisions Housing Rent levels**

£	Original 2011/12	Forward Projection 2012/13	Forward Projection 2013/14	Forward Projection 2014/15
Variance change in original to revised spending programme	-173.38	-7.87	-113.65	-116.67

28. This indicator shows the revenue impact on any newly approved schemes if there was no rent restructuring in place. However, there is no actual impact on rent levels through any decisions on capital investments due the operation of rent restructuring currently.

**SECTION 2 - TREASURY MANAGEMENT STRATEGY 2012/13 to 2014/15**

29. The treasury management service is an important part of the overall financial management of the Council's affairs. The prudential indicators in Section 1 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 balanced budget requirement under the Local Government Finance Act 1992.
30. 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 2011). This Council adopted the Code of Practice on Treasury Management on 23 June 2004, and will adopt the revised Code.
31. As a result of adopting the Code the Council also adopted a Treasury Management Policy Statement which is also a requirement of one of the prudential indicators and is outlined below:
- The organisation defines its treasury management activities as: the management of the organisations investments and cash flows, its banking, money market and capital market transactions; the effective control of risks associated with those activities; and the pursuit of optimum performance consistent with those risks.
  - The organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage risks.
  - The organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principle of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, with the context of effective risk management.
32. 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 reports are produced after the year-end to report on actual activity for the year as was in year reporting of at least half-yearly.

33. This strategy covers:
1. The Council's debt and investment projections;
  2. The Council's estimates and limits on future debt levels;
  3. The expected movement in interest rates;
  4. The Council's borrowing and investment strategies;
  5. Treasury performance indicators; and
  6. Specific limits on treasury activities.

**Debt and Investment Projections 2012/13 – 2014/15**

34. The borrowing requirement comprises the expected movement in the CFR 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.
35. The borrowing position is expected to change significantly in 2012 as, the Council will be required to make a one off payment to the CLG to remove the HRA from the current housing subsidy system. The payment is expected to be £122m. This one off payment is compensation, ensuring the HRA will no longer make future annual payments to the CLG. Therefore, the relevant prudential indicators have been updated to reflect this.
36. The Councils revised treasury portfolio position at 31 March 2012, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (CFR), highlighting any over or under borrowing.

£m	2011/12 Revised £	2012/13 Estimated £	2013/14 Estimated £	2014/15 Estimated £
<b>External Debt</b>				
Existing Debt at 1 April	(2.591m)	(124.886)	(122.484m)	(118.999m)
Expected change in debt	0.026m	0.026m	1.026m	0.013m
HRA Settlement	(122.321m)	2.376m	2.459m	2.545m
<b>Debt at 31 March</b>	<b>(124.886m)</b>	<b>(122.484m)</b>	<b>(118.999m)</b>	<b>(116.441m)</b>
<b>CFR</b>	129.143m	128.956m	128.777m	128.605m
<b>Under / (over) borrowing</b>	4.257m	6.472m	9.778m	12.164m
<b>Total Investments at 31 March</b>	<b>31.771m</b>	<b>29.706m</b>	<b>34.652m</b>	<b>40.901m</b>
Investment change	(1.850m)	(2.065m)	4.946m	6.249m
<b>Net Debt</b>	<b>(95.485m)</b>	<b>(95.148m)</b>	<b>(86.717m)</b>	<b>(77.910m)</b>

37. As part of the HRA reform payment to CLG the operational boundary has increased by £130m to £133m. This limit has been set to ensure sufficient headroom is in place to allow the repayment as part of the Councils prudential indicators.

**Limits to Borrowing Activity**

38. Within the prudential indicators there are a number of key indicators to ensure the Council operates its activities within well defined limits.
39. The Head of Finance 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 the proposals in this budget report.
40. **The Operational Boundary.** This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational Boundary £m	2011/12 Revised £	2012/13 Estimated £	2013/14 Estimated £	2014/15 Estimated £
Debt	2.565m	2.539m	1.513m	1.500m
+ HRA Reform	122.321m	119.945m	117.486m	114.941m
Other long term liabilities	0.000m	0.000m	0.000m	0.000m
<b>Total</b>	<b>124.886m</b>	<b>122.484m</b>	<b>118.999m</b>	<b>116.441m</b>

41. **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.
42. 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.
43. The Council is asked to approve the following Authorised Limit taking into account the expected self-financing payment to CLG as part of the HRA reform:

Authorised limit £m	2011/12 Revised £	2012/13 Estimated £	2013/14 Estimated £	2014/15 Estimated £
Debt	18.000m	18.000m	18.000m	18.000m
+ HRA Reform	130.000m	130.000m	130.000m	130.000m
Other long term liabilities	-	-	-	-
<b>Total</b>	<b>148.000m</b>	<b>148.000m</b>	<b>148.000m</b>	<b>148.000m</b>

**Prospects for Interest Rates**

44. The Council has appointed Sector as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Annex 1 draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Sector central view

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

\* Borrowing Rates

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

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

47. This challenging and uncertain economic outlook has a several key treasury magement implications:

- The Eurozone sovereign debt difficulties, most evident in Greece, provide a clear indication of much higher counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2012/13;
- Borrowing interest rates are currently attractive, but may remain low for some time. The timing of any borrowing will need to be monitored carefully;

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

A more detailed economic outlook for both the Global and UK economy is included in Annex 2.

### **Borrowing Strategy 2012/13 – 2014/15**

48. The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), 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. This strategy is prudent as investment returns are low and counterparty risk is high and will be maintained for the borrowing excluding the HRA reform settlement
49. Against this background and the risks within the economic forecast, caution will be adopted with the 2012/13 treasury operations. The Head of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.
50. The requirement for the HRA reform settlement to be made to the CLG on 28 March 2012 will require a separate consideration of a borrowing strategy. The Council will need to have the cash settlement amount of £122m available by the 28<sup>th</sup> March 2012, so separate borrowing solely for this purpose is anticipated. The PWLB are providing loans at interest rates 0.85% lower than the usual PWLB interest rates solely for the settlement requirements. This provides a compelling reason to utilise this borrowing availability. The exact structure of debt to be drawn is currently being considered by officers to ensure it meets the requirements of the HRA business plan and the overall requirements of the Council.
51. 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.
52. 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 investments returns.

### **Treasury Management Limits on Activity**

53. There are three debt related treasury activity limits. 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.

54. The Council is asked to approve the limits:

£m	2011/12	2012/13	2013/14	2014/15
<b>Interest rate Exposures</b>				
	Upper	Upper	Upper	Upper
Limits on fixed interest rates based on net debt	<b>133.000m</b>	<b>133.000m</b>	<b>133.000m</b>	<b>133.000m</b>
Limits on variable interest rates based on net debt	<b>40.000m</b>	<b>40.000m</b>	<b>40.000m</b>	<b>40.000m</b>
<b>Maturity Structure of fixed interest rate borrowing 2012/13</b>				
	Lower	Upper	Upper	
Under 12 months	0%	<b>40%</b>	<b>0%</b>	
12 months to 2 years	0%	<b>40%</b>	<b>40%</b>	
2 years to 5 years	0%	<b>100%</b>	<b>100%</b>	
5 years to 10 years	0%	<b>100%</b>	<b>100%</b>	
10 years and above	0%	<b>100%</b>	<b>100%</b>	

**Policy on Borrowing in Advance of need**

55. The Council will not borrow more than or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

56. The Head of Finance 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 Head of Finance 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.

57. It would not look to borrow more than 24 months in advance of need.

58. Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

### Debt Rescheduling

59. As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).
60. The reasons for any rescheduling to take place will include:
- the generation of cash savings and / or discounted cash flow savings;
  - helping to fulfil the treasury strategy;
  - enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).
61. Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

**SECTION 3 - ANNUAL INVESTMENT STRATEGY 2012/13 to 2014/15**

**Investment Policy**

62. The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.
63. In accordance with the above, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings and watches published by all three ratings agencies with a full understanding of what the ratings reflect in the eyes of each agency. Using the Sector ratings service banks' ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.
64. Further, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "Credit Default Swaps" and overlay that information on top of the credit ratings. This is encapsulated within the credit methodology provided by the advisors, Sector.
65. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
66. The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk.
67. The intention of the strategy is to provide security of investment and minimisation of risk.
68. Investment instruments identified for use in the financial year are listed in Annex 3 under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules
69. **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.
70. The Head of Finance will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to either Council or Governance and Audit Committee 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.
71. 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 (where rated). 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.
72. Credit rating information is supplied by Sector, the Councils 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.
73. The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) is:
- **Banks & Building Societies** – the Council will use a criteria based system covering Banks & Building Societies. (see Annex 3 for specific criteria).
  - The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity)
  - A local authority
  - Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency.
  - Local Authority Mortgage scheme (although this is classified as being a service investment rather than a treasury investment, and is therefore outside of the Specified / Non-specified categories).

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 investment prudential indicator below

74. The proposed criteria for Specified and Non-Specified investments are shown in Annex 3 for approval along with monetary limits for each type of counterparty.

75. **Use of additional information other than credit ratings.** Additional requirements under the Code 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.

### Investment Strategy

76. **In-house funds.** Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

77. **Investment returns expectations.** Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 3 of 2013. Bank Rate forecasts for financial year ends (March) are:

- 2011/12            0.50%
- 2012/13           0.50%
- 2013/14           1.25%
- 2014/15           2.50%

78. There are downside risks to these forecasts (i.e. start of increases in Bank Rate is delayed even further) if economic growth remains weaker for longer than expected. However, should the pace of growth pick up more sharply than expected there could be upside risk, particularly if Bank of England inflation forecasts for two years ahead exceed the Bank of England's 2% target rate.

79. The suggested budgeted investment earnings rates for returns on investments placed for periods up to one year during each financial year for the next three years are as follows:

- 2012/13           1.50%
- 2013/14           1.90%
- 2014/15           3.10%

80. **Investment treasury indicator and limit** - 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.

81. The Council is asked to approve the treasury indicator and limit: -

Maximum principal sums invested > 364 days			
£m	2012/13	2013/14	2014/15
<b>Principal sums invested &gt; 364 days</b>	<b>£8.000m</b>	<b>£9.000m</b>	<b>£10.000m</b>

82. **Risk Benchmarking** – A development in the revised Codes and the CLG Investment Guidance 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.

83. 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.

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

- 0.1% historic risk of default when compared to the whole portfolio.

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

- Bank overdraft - £0.25m
- Liquid short term deposits of at least £3m available with a week's notice.
- Weighted Average Life benchmark is expected to not exceed a maximum of 1 year.

86. **Yield - Local measures of yield benchmarks are :**

- Investments – Internal returns above the 7 day LIBID rate
- Investments – External fund managers - returns 10% above 7 day compounded LIBID.

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

	1 year	2 years	3 years	4 years	5 years
<b>Maximum</b>	<b>0.08%</b>	<b>0.22%</b>	<b>0.37%</b>	<b>0.52%</b>	<b>0.70%</b>

Note: This benchmark is an average risk of default measure (potential loss on investments), and would not constitute an actual expectation of loss against a particular investment.

### **Performance Indicators**

88. 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 (London Interbank Bid Rate)
- Investments – External fund managers - returns 110% above 7 day compounded LIBID.

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

### **Policy on Use of External Service Providers**

89. The Council uses Sector as its external treasury management advisors.
90. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.
91. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

### **Member and Officer Training**

92. 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:
- Carrying out a programme of specific Treasury Management training with the members of the Governance and Audit Committee
  - Improved Governance arrangements through annual report and midyear strategy revisions had aided the development and knowledge of committee members.
  - Ensuring staff involved in the Treasury Management function are suitably qualified and have access to regular information updates and developments within the treasury arena.

Annex 1 - Interest Rate Forecast 2011/2015

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

### Annex 2 – Economic Background 2011/2015

#### **Global economy**

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

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

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

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

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

#### **UK economy**

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

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

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

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

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

### **Sector's forward view**

Economic forecasting remains troublesome with so many external influences weighing on the UK. There does, however, appear to be consensus among analysts that the economy remains weak and whilst there is still a broad range of views as to potential performance, they have all been downgraded throughout 2011. Key areas of uncertainty include:

- a worsening of the Eurozone debt crisis and heightened risk of the breakdown of the bloc or even of the currency itself;
- the impact of the Eurozone crisis on financial markets and the banking sector;
- the impact of the Government's austerity plan on confidence and growth and the need to rebalance the economy from services to exporting manufactured goods;
- the under-performance of the UK economy which could undermine the Government's policies that have been based upon levels of growth that increasingly seem likely to be undershot;
- a continuation of high levels of inflation ;
- the economic performance of the UK's trading partners, in particular the EU and US, with some analysts suggesting that recession could return to both;
- stimulus packages failing to stimulate growth;
- elections due in the US, Germany and France in 2012 or 2013;
- potential for protectionism i.e. an escalation of the currency war / trade dispute between the US and China.

The overall balance of risks remains weighted to the downside. Lack of economic growth, both domestically and overseas, will impact on confidence putting upward pressure on unemployment. It will also further knock levels of demand which will bring the threat of recession back into focus.

Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries.

Given the weak outlook for economic growth, Sector sees the prospects for any interest rate changes before mid-2013 as very limited. There is potential for the start of Bank Rate increases to be even further delayed if growth disappoints.

### Annex 3

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

CLG issued Investment Guidance in 2010, and this forms the structure of the Council's policy below. 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 23 June 2004 and will apply its principles to all investment activity. In accordance with the Code, the Head of Finance has produced its 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.

The criteria enable the Council to choose Specified and Non Specified investments. The rating criteria is based on the Lowest Common Denominator method (LCD - this includes ratings by Standard and Poor's, Moody's and Fitch) and institutions must meet all criteria (where rated) in order for the Council to place investments with them.

**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 low risk assets where the possibility of loss of principal or investment income is small. The Council's Treasury Management Officer is restricted to placing Specified Investment funds with:

Table A – Specified Investments

	Specified Investments Category	Limit																											
a	<p><b>A body of high credit quality</b>, this category includes the following -</p> <p><input type="checkbox"/> A UK bank or building society awarded a high credit rating by a credit rating agency, meeting the following criteria using the LCD method</p> <table border="1"> <thead> <tr> <th colspan="4">Fitch</th> <th colspan="3">Moody's</th> <th colspan="2">Standard and Poor's</th> </tr> <tr> <th>Short Term</th> <th>Long Term</th> <th>Viability</th> <th>Support</th> <th>Short Term</th> <th>Long Term</th> <th>Financial Strength</th> <th>Short Term</th> <th>Long Term</th> </tr> </thead> <tbody> <tr> <td>F1</td> <td>AA-</td> <td>BB+</td> <td>3</td> <td>P1</td> <td>Aa3</td> <td>C</td> <td>A-1</td> <td>AA-</td> </tr> </tbody> </table> <p><input type="checkbox"/> A body of high credit quality that was an Eligible Institution under the UK Government's Asset protection scheme, and with minimum criteria of F1, A+ and equivalent from Moody's and Standard &amp; Poor's using the LCD method. The counterparty may also have a proportion of the UK government ownership.</p> <p><input type="checkbox"/> Part nationalised banks can be included within specified investments as long as they remain part-nationalised or meet the ratings criteria as outlined above.</p>	Fitch				Moody's			Standard and Poor's		Short Term	Long Term	Viability	Support	Short Term	Long Term	Financial Strength	Short Term	Long Term	F1	AA-	BB+	3	P1	Aa3	C	A-1	AA-	<p>£10m per institution or a maximum of 30% of fixed term investment (whichever is the greatest), £10m per corporate group</p>
Fitch				Moody's			Standard and Poor's																						
Short Term	Long Term	Viability	Support	Short Term	Long Term	Financial Strength	Short Term	Long Term																					
F1	AA-	BB+	3	P1	Aa3	C	A-1	AA-																					
b	<b>The UK Government</b> (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity)	no amount limit																											
c	<b>UK local authorities</b>	£5m per LA, £10m all LAs																											
d	<p><b>Pooled investment vehicles</b> (such as money market funds) that have been awarded a high credit rating by a credit rating agency. This category covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's or Fitch rating agencies.</p> <p>CLG Investment Guidance specifies that Money Market Funds with high credit ratings are classified as Specified Investment. These funds are instant access investment. There is possibility that part of the investment may be exposed to counterparties the Council would not approve normally or invest directly. The counterparty risk is mitigated by that –</p> <ul style="list-style-type: none"> <li>• The Fund Managers diversify investment in a range of counterparties;</li> <li>• The Funds are instant access;</li> <li>• The Council only invests in funds rated AAA;</li> <li>• DCLG Investment Guidance classifying such funds as Specified Investment.</li> </ul>	£5m per fund,																											

**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:

Amounts invested with any one institution shall not exceed £2m for periods of more than 2 years. Amounts invested with any one corporate group shall not exceed £5m (with the exception of Councils own bank).

Amounts invested in non specified fixed term investment would normally not exceed 25% of total funds placed in fixed term deposit. The Head of Finance has the discretion to exceed the limit within reasons. If these circumstances are required this will be reported back to the appropriate committee.

**Table B – Non Specified Investments**

	<b>Non Specified Investment Category</b>	<b>Limit</b>
a.	<b>Any institutions meeting the criteria set out for Specified Investments</b> , with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	£4m maximum of 2 years per institution
b.	<b>Councils Bank</b> – Should its ratings fall below that required for specified investment, monies will be restricted to instant access.	£7m
c.	<b>Top 10 building societies, by asset value.</b>	£2m, 2 years per institution. £5m for all B/S sector

**Local Authority Mortgage Scheme.** Under this scheme the Council will place a maximum fund of £5m, with one of the approved lenders participating in the LAMS scheme for a fixed period of 5 years. This is classified as being a service investment, rather than a treasury management investment, and is therefore outside of the Specified / Non specified categories

**The Monitoring Investment Counterparties** - The credit rating of counterparties will be monitored regularly. The Council receives credit rating advice from its advisers, Sector, on a daily basis and 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 Head of Finance, and if required new counterparties which meet the criteria will be added to the list.

**Use of External Fund Managers** –The Council currently uses external fund managers for part of its investment portfolio. The Council is not restricted to placing funds with cash managers, and will manage funds in house, use fund managers, or brokers if it is appropriate to do so.

The fund managers will use both specified and non-specified investment categories, and are contractually committed to keep to the Council’s investment strategy.

Currently the Council has an agreement with Tradition UK and Sterling International. The fund managers are required to adhere to the following:

- All investments restricted to sterling denominated instruments;
- Amounts invested with any one institution or Corporate Group should not exceed the limits specified in Table A and Table B.
- Portfolio management is measured against the return provided by the 3 month sterling LIBID, or in accordance with the measures specified in the contract.

The performance of investment managed by Fund Managers is reviewed at least quarterly by the Head of Finance.

**Ethical Investment Statement** - The council has approved the following ethical investment statement that will apply to all cash investments made by, or on behalf of, the council

“The Council, in making investments through its treasury management function, fully supports the ethos of socially responsible investments. We will actively seek to communicate this support to those institutions we invest in as well as those we are considering investing in by:

- encouraging those institutions to adopt and publicise policies on socially responsible investments;
- requesting those institutions to apply council deposits in a socially responsible manner.”

Counterparties shall be advised of the above statement.

**Annex 4**

**Risk Management** – The Council undertakes risk assessment for all fixed term deposits. The risk assessment uses the following template –

**Risk assessment of new investment (last updated August 2009)**

Investment	Institution	Risk Assessment		
Investment Product	Institution name	<i>Risk of the counterparty defaulting on investment</i>		<i>Likelihood</i>
Principal Value	Eligibility	Counterparty on our specified list: Instant access	1.4	
		Counterparty only on non specified list: Instant access	1.7	
		Counterparty on our specified list: <=364 days	2	Unlikely
Term	Limit with this institution	Counterparty only on non specified list: <=364 days	2.4	
		Counterparty only on non specified list: >364 days	3	Likely
Rate	Existing investment value	<i>Impact of losing the investment</i>		<i>Impact</i>
Rate %	Value inc new investment	Total principal less than £700,000	1	Negligible
		Total principal between £700,000 and £1.4m	2	Minor
		Total principal between 1.4m and £3.5m	3	Major
		Total principal greater than £3.5m	4	Critical

**Risk Score :**

Internal Reference

Is it within the limit?

Risk assessed by:

Risk assessment date: