Report for Resolution

Report to	Council 30 March 2010	9
Report of	Head of Finance	
Subject	Treasury Management Strategy 2010/11	

Purpose

This report outlines the Council's prudential indicators for 2010/11 through to 2012/13 and sets out the expected treasury operations for this period. It fulfils three key reports required by the Local Government Act 2003:

- *The reporting of the prudential indicators as required by the CIPFA Prudential Code for Capital Finance in Local Authorities (Appendix A);*
- *The Minimum Revenue Provision (MRP) Policy, as required by Regulation under the Local Government and Public Involvement in Health Act 2007 (Appendix A);*
- *The treasury strategy in accordance with the CIPFA Code of Practice on Treasury Management (Appendix B);*

The investment strategy is in accordance with the Department of Communities and Local Government investment guidance (Appendix B).

A summary report outlines the key requirements from these reports.

Recommendations

The Council is recommended to:

1. Approve the Minimum Revenue Provision Policy.
2. Approve the Treasury Management Strategy 2010/11 (Appendix B), and the Prudential Indicators and Limits for 2010/11 to 2012/13 (highlighted in Appendix A.)
3. Approve the Investment Strategy 2010/11 contained in the treasury management strategy (Appendix B) and the detailed criteria included in Annex B1.
4. Revision to the Council's standing orders at Annex B2, including the recommendation that Executive continues to be responsible for the effective scrutiny of the treasury management strategy and policies.
5. Note the commentary and the explanation of changes adopted as required in the revised editions of the CIPFA Prudential Code and CIPFA Treasury Management Code of Practice produced in November 2009 (included in the report below.)

Financial Consequences

The report has no direct financial consequences however it does set the guidelines for how the Council manages its borrowing and investment resources

Contact Officers

Barry Marshall 01603 212556

Executive Report

Financial Markets Context

Previous twelve months - The last twelve months has seen a continuation of the challenging financial markets for the Council's treasury management team. The number of institutions that have met the Council's rating criteria has reduced and further erosion of confidence has been experienced in non rated building societies, several of which have merged with larger organisations to stay in operation. Investments have been gradually moved into rated building societies and close adherence to the overall rating, investment maximum and percentage long versus short criteria has been maintained. At 31 January 2010 the Council had £30 m invested, £25m invested in UK building societies, and £5m in UK banks.

Current Position - The Council is continuing to see a fall in its investment income with the interest rates falling from 1.625% at the start of the year to 0.616% at the end of January (based on the 3 month LIBOR* rate.) The average rate achieved from April 09 to January 10 on deals over 3 months was 3.66% and 0.41% for deals less than 3 months. The favourable variance to LIBOR on the deals over 3 months is due to retaining some longer term investments that were secured in previous years when the rates were higher.

As our longer term higher interest rated investments reach maturity, the Council will see a continuing decline in income as the financial markets plateau before climbing in line with the exit from recession. The reduction in investment income is included within the budget forecasts reported at this Council meeting.

The Future – The reduction in investment income together with the need to transfer funds into reserve in the budget forecasts for 2010/11 onwards, impact on the overall budget requirement. The focus within the strategy and policies is on mitigating risk to ensure more significant principle losses are avoided. Butlers Treasury Management Consultants are forecasting a gradual rise in the 3 month money rate to 1.25% by March 11 which will provide some opportunity to place investments at more favourable rates in the future.

Regulatory Changes

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. Where appropriate the revised guidance has been incorporated into these reports.

The main changes initiated in the revisions involve member training, frequency of information and scrutiny, together with the identification of a specific body that is responsible for ensuring effective scrutiny of the treasury management strategy and policies, before making recommendations to Council, (for Norwich this is the Executive,)

** LIBOR – London Inter Bank Offered Rate*

Executive Summary

1 Capital Expenditure - The capital plan to be approved at this Council meeting projects capital expenditure as follows:-

Capital expenditure £ '000's	2009/10 Revised	2010/11 Estimated	2011/12 Estimated	2012/13 Estimated
Non HRA	6,821	9,704	4,840	2,240
HRA	21,339	22,529	20,148	15,748
Total	28,160	32,233	24,988	17,988

2 Debt Requirement - Part of the capital expenditure programme will be financed directly (through Government Grants, capital receipts etc., leaving a residue which will increase the Council's external borrowing requirement (its Capital Financing Requirement – CFR). The General Fund CFR is reduced each year by a statutory revenue charge for the repayment of debt (there is no requirement for an HRA charge).

Capital Financing Requirement £'000's	2009/10 Revised	2010/11 Estimated	2011/12 Estimated	2012/13 Estimated
Non HRA	32,472	31,239	29,849	28,657
HRA	54,671	54,857	55,150	55,242
Total	87,143	86,096	84,999	83,899

Against this borrowing need (the CFR), the Council's expected external debt position for each year (the Operational Boundary), and the maximum amount it could borrow (the Authorised Limit) are:

£'000's	2009/10 Estimated	2010/11 Estimated	2011/12 Estimated	2012/13 Estimated
Authorised limit	110,571	108,931	107,242	105,549
Operational boundary	90,571	88,931	87,242	85,549

The increase in the operational and authorised limits this year are to allow for future borrowing requirement to enable the Council to take advantage of possible future investment opportunities and capital investment. If exercised these investments will have to meet the requirements of the Prudential Code, which stipulate that all capital expenditure should have due regard to the following:

- service objectives
- stewardship of assets
- value for money
- prudence and sustainability
- affordability
- practicality

The Operational and Authorised Limits may need to be increased in the future by between £100m - £200m to align the Council's strategic limits with additional borrowing arising out of the review of the HRA Subsidy system and the proposals to achieve self-financing Housing Revenue Accounts through redistributed HRA debt.

The impact of the new schemes being approved as part of this budgetary cycle on Council Tax and housing rents are expected to be:

Incremental impact of capital investment decisions (£) on:	**2008/09 Revised**	**2009/10 Estimated**	**2010/11 Estimated**	**2011/12 Estimated**
Band D Council Tax	0.00	0.00	0.00	0.00
Housing rents levels	0.00	0.00	0.00	0.00

3 Investments – The resources applied to finance the capital spend above is one of the elements which influence the overall resources of the Council. The expected position of Council's year end resources (balances, capital receipts, etc.), is shown below supplemented with the expected cash flow position to provide an overall estimate of the year end investment position. The prudential indicator limiting longer term investments is also shown.

£'000's	**2009/10 Revised**	**2010/11 Estimated**	**2011/12 Estimated**	**2012/13 Estimated**
Total resources	18,983	20,542	14,632	6,033
Working Capital	14,194	13,910	13,632	13,360
Total Investments	28,300	23,460	21,114	21,000
Principal sums invested > 364 days		10,000	5,300	5,000

Appendix A

The Prudential Indicators 2009/10 – 2012/13

Introduction

1. The Local Government Act 2003 requires the Council to adopt the CIPFA Prudential Code and produce prudential indicators. This report revises the indicators for 2009/10, 2010/11 and 2011/12, and introduces new indicators for 2012/13. Each indicator either summarises the expected activity or introduces limits upon the activity, and reflects the outcome of the Council's underlying capital appraisal system.
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 2010/11 is included in Appendix B to complement the indicators, and this report includes the prudential indicators relating to the treasury activity.

The Capital Expenditure Plans

3. 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)
   - Affordability (e.g. implications for the council tax and rents)
   - Practicality (e.g. the achievability of the forward plan.)

4. The revenue consequences of capital expenditure, will need to be paid for from the Council's own resources.
5. 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.
6. 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. For instance anticipated asset sales have been postponed due to the impact of the recession on the property market.

7. The Council is asked to approve the summary capital expenditure projections below. This forms the first prudential indicator:

£'000's	**2009/10 Revised**	**2010/11 Estimated**	**2011/12 Estimated**	**2012/13 Estimated**
Capital Expenditure				
Non-HRA	6,821	9,704	4,840	2,240
HRA	21,339	22,529	20,148	15,748
Total Expenditure	**28,160**	**32,233**	**24,988**	**17,988**
Financed by:				
Capital grants	3,479	6,138	743	426
Major Repairs Allowance	9,879	9,846	9,944	10,044
Highways Programme	0	0	0	0
Revenue Contributions	6,136	2,723	4,192	5,818
Leaseholders	250	250	250	250
Capital receipts	5,134	12,095	9,409	600
S106 funds	3,282	1,181	450	850
Total Resources	**28,160**	**32,233**	**24,988**	**17,988**
Net financing need for the year	**0**	**0**	**0**	**0**

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

8. 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 the Council's underlying borrowing need. The capital expenditure above which has not immediately been paid for will increase the CFR.

9. 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.)

Minimum Revenue Provision Policy

10. 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**:

- MRP will follow the existing practice set down in previous years for Supported Capital Expenditure
- For unsupported borrowing (including PFI and Finance Leases,) the MRP policy will be the **Asset Life** method, where the MRP will be based on the estimated life of the assets, in accordance with the proposed regulations.

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

£'000's	2009/10 Revised	2010/11 Estimated	2011/12 Estimated	2012/13 Estimated
Capital Financing Requirement				
CFR – Non Housing	32,472	31,239	29,849	28,657
CFR – Housing	54,671	54,857	55,150	55,242
Total CFR	**87,143**	**86,096**	**84,999**	**83,899**
Movement in CFR	**(1,028)**	**(1,047)**	**(1,097)**	**(1,100)**
Movement in CFR represented by				
Net financing need for the year (above)	0	0	0	0
MRP/VRP and other financing movements	1,028	1,047	1,097	1,100
Movement in CFR	**1,028**	**1,047**	**1,097**	**1,100**

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

12. 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 £'000's	2009/10 Revised	2010/11 Estimated	2011/12 Estimated	2012/13 Estimated
Fund balances	9,735	12,078	14,072	16,067
Capital receipts	5,134	12,095	9,409	600
Earmarked reserves etc	832	1,232	1,732	2,232
S106	3,282	1,181	450	850
Total Core Funds	**18,983**	**26,586**	**25,663**	**19,749**
Working Capital*	14,194	13,910	13,632	13,360
Expected Investments	**28,300**	**40,496**	**39,295**	**33,109**

Working capital balances shown are estimated for year end, these may be higher mid year.

Limits to Borrowing Activity

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

14.

15. 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 CFR in the preceding year plus the estimates of any additional CFR for 2010/11 and the following two financial years. This allows some flexibility for limited early borrowing for future years.

£'000's	2009/10 Revised	2010/11 Estimated	2011/12 Estimated	2012/13 Estimated
Gross Borrowing (excluding financial instrument adjustments)	83,592	83,592	83,592	83,592
Less Transferred Debt	2,723	2,502	2,299	2,113
	80,869	**81,090**	**81,293**	**81,479**
Investments	28,300	23,460	21,114	21,000
Net Borrowing	52,569	57,630	60,179	60,479
	80,869	**81,090**	**81,293**	**81,479**
CFR	**87,143**	**86,096**	**84,999**	**83,899**

16. 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.

17. A further two prudential indicators control or anticipate the overall level of borrowing. These are:

18. **The Authorised Limit for External Debt** – 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.

19. **The Operational Boundary for External Debt** –This indicator is based on the expected maximum external debt during the course of the year; it is not a limit.

20. The Council is asked to approve the following Authorised Limit and Operational Boundary:

Authorised Limit £'000's	**2009/10 Estimated**	**2010/11 Estimated**	**2011/12 Estimated**	**2012/13 Estimated**
Borrowing	107,109	106,062	104,965	103,864
Other long term liabilities	3,462	2,869	2,277	1,685
Total	110,571	108,931	107,242	105,549
Operational Boundary £'000's	**2009/10 Estimated**	**2010/11 Estimated**	**2011/12 Estimated**	**2012/13 Estimated**
Borrowing	87,143	86,096	84,999	83,899
Other long term liabilities	3,428	2,835	2,243	1,650
Total	90,571	88,931	87,242	85,549

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.

%	**2009/10 Revised**	**2010/11 Estimated**	**2011/12 Estimated**	**2012/13 Estimated**
Non-HRA	5.03	6.40	6.63	6.50
HRA	10.41	13.23	13.71	13.44

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 years 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**

£	**Proposed Budget 2010/11**	**Forward Projection 2011/12**	**Forward Projection 2012/13**
Council Tax - Band D	0.00	0.00	0.00

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 weekly rent levels.

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

£	**Proposed Budget 2010/11**	**Forward Projection 2011/12**	**Forward Projection 2012/13**
Weekly Housing Rent levels	0.00	0.00	0.00

28. This indicator shows the revenue impact on any newly approved schemes, although any discrete impact will be constrained by rent controls.

Appendix B

Treasury Management Strategy 2009/10 – 2011/12

1. 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 balanced budget requirement under the Local Government Finance Act 1992. There are specific treasury prudential indicators included in this strategy which require approval.

2. 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 2 April 2002, and as a result adopted a Treasury Management Policy Statement. This adoption meets the requirements of the first of the treasury prudential indicators. However the revised Code of Practice has amended the Treasury Management Policy Statement and this is appended at Annex B3 for approval.

3. The Constitution, Policy and the Council's Financial Regulations require 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. The authority has produced a mid year performance report in the past and this is now a new requirement of the revision of the Code of Practice.

4. This strategy covers:

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

   The Council's estimates and limits on future debt levels are included within Appendix A and again below.

Debt and Investment Projections 2010/11 – 2012/13

5. 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. It also highlights the expected change in investment balances.

£'000's	2009/10 Revised	2010/11 Estimated	2011/12 Estimated	2012/13 Estimated
External Debt				
Debt at 1 April	83,592	83,592	83,592	83,592
Expected change in debt	0	0	0	0
Debt at 31 March	83,592	83,592	83,592	83,592
Operational Boundary	90,571	88,931	87,242	85,549
Investments				
Total Investments at 31 March	28,300	23,460	21,114	21,000
Investment change	-64	-4,840	-2,346	-114

6. The related impact of the above movements on the revenue budget are:

£'000's	2009/10 Revised	2010/11 Estimated	2011/12 Estimated	2012/13 Estimated
Revenue Budgets				
Interest on Borrowing	6,543	6,478	6,413	6,349
Related HRA Charge	4,410	4,366	4,323	4,279
Net General Fund Borrowing Cost	2,133	2,111	2,090	2,069
Investment income	3,275	2,715	2,443	2,430

7. Borrowing in advance of need – The Council has some flexibility to borrow funds this year for use in future years. The Director 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 Director 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. Borrowing in advance will be made within the following constraints, which are in accordance with draft CLG guidance:
   - It will be limited to no more than 20% of the expected increase in borrowing need (CFR) over the three year planning period; and
   - Would not look to borrow more than 6 months in advance of need
8. 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.

Expected Movement in Interest Rates –

Medium-Term Rate Forecasts (averages)

Annual Average %	Bank Rate	Money Rates		PWLB Rates*		
		3 month	1 year	5 year	20 year	50 year
2009/10	0.5	0.8	1.4	3.2	4.4	4.6
2010/11	0.9	1.1	2.1	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 Strategy 2009/10 – 2011/12

9. 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.

17. Long-term fixed interest rates are at risk of being higher over the medium term. The Head of Finance, under delegated powers, will take the most appropriate form of borrowing 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.

18. With the likelihood of longer term rates increasing, debt restructuring is likely to focus on switching from longer term fixed rates to cheaper shorter term debt, although the Director of Finance and treasury consultants will monitor prevailing rates for any opportunities during the year.

19. 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.

Investment Counterparty and Liquidity Framework

20. **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.

21. **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.

22. 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.

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

    - 0.05% historic risk of default when compared to the whole portfolio

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

    - Bank overdraft £1.3m
    - Liquid short term deposits of at least £1m available with a week's notice.
    - Current Weighted Average Life of an investment is expected to be 0.45 years, with a maximum of 2.77 years.

25. Yield – Local measures of yield benchmarks are:

- Investments – internal returns above the 7 day LIBID rate

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

	1 year	2 years	3 years	4 years	5 years
Maximum	0.05%	0.04%	0.03%	0.02%	0.01%

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

27. **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:

    - Secondly that 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.
    - Thirdly that 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.

28. The Head of Finance 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.

29. 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.

30. 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 at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions .

31. 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: i) are **UK banks** and/or ii) Are **non-UK** and domiciled in a country which has a minimum Sovereign long term rating of AAA And have, as a **minimum,** the following Fitch, Moody's and Standard and Poors credit ratings (where rated): **i) Short Term** – F1 **ii) Long Term** – A+/A **iii) Individual / Financial Strength** – *B/C* (Fitch / Moody's only) **iv) Support –** 3 **(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, 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.
Banks 4	The Council's own banker for transactional purposes 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 and i)Have assets in excess of £250m ii)And the investment is subject to 1% of the society's assets
Other	i) **Money Market Funds** where the investees within the fund accord with the rating requirements set out above ii) **UK Government** - (including gilts and the DMADF) iii) **Local Authorities, Parish Councils etc** iv) **Supranational institutions** v) **Non-Specified investments** - A limit of 2% will be applied to the use of Non-Specified investments.

32. **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:

i) no more than £5m will be placed with any non-UK country at any time;

ii) limits in place above will apply to Group companies

iii) Sector limits will be monitoring regularly for appropriateness.

33. **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.

32. **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)	**Moody's**	**Standard & Poors**	**Money Limit**	**Time Limit**
Upper Limit Category	*F1,A*	P-1,A2	A-1, A	£5m	4yrs
Lower Limit Category	Unrated Building Societies			£5m or 1%	4yrs
Other Institution Limits – UK Local Authorities Unrated Wholly owned Subsidiaries	-	-	-	£5m	364 days 3 mths
Guaranteed Organisations	-	-	-	£5m	3mths
The Council's Bankers	-	-	-	£5m	1mth

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

34. 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.

35. 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.

36. **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.

37. 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.

38. **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 Finance 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.**

39. 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

40. 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.

£m	2010/11 Estimated + 1%	2010/11 Estimated - 1%
Revenue Budgets		
Interest on Borrowing	*	*
Related HRA Charge	*	*
Net General Fund Borrowing Cost	*	*
Investment income	2,798	2,796

* No impact on Borrowing as all borrowing is at a fixed rate of interest.

Treasury Management Limits on Activity

41. 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.

42. 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	100%	100%	100%
Limits on variable interest rates based on net debt	20%	20%	20%
Limits on fixed interest rates: • ***Debt only*** • ***Investments only***	 *100%* *100%*	 *100%* *100%*	 *100%* *100%*
Limits on variable interest rates • ***Debt only*** • ***Investments only***	 *20%* *20%*	 *20%* *20%*	 *20%* *20%*
Maturity Structure of fixed interest rate borrowing 2010/11			
		Lower	**Upper**
Under 12 months		0%	10%
12 months to 2 years		0%	10%
2 years to 5 years		0%	30%
5 years to 10 years		0%	50%
10 years and above		0%	95%
		Lower	***Upper***
Under 12 months		*0%*	*10%*
12 months to 2 years		*0%*	*10%*
2 years to 5 years		*0%*	*30%*
5 years to 10 years		*0%*	*50%*
10 years and above		*0%*	*95%*
Maximum principal sums invested > 364 days			
Principal sums invested > 364 days	£8m	£8m	£5m

Performance Indicators

43. 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. The authority will report the internal returns on the investment portfolio above the 7 day LIBID rate in its Treasury Management Investment Performance Report.

A local indicator has been set within the Service Team Plan to achieve 105% above the LIBOR rate. (LIBOR is a more challenging target on which to gauge performance when compared to the LIBID counterpart.) The results of these indicators will be reported in the Treasury Annual Report.

Treasury Management Advisers

44. The Council uses Butlers as its treasury management consultants. 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

44. 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:

    - providing opportunities for internal staff to attend training session and regular treasury management seminars on market issues
    - planning a members training session with the treasury management consultants

Treasury Management Practice (TMP) 1 (5) – 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 02/04/2002 and will apply its principles to all investment activity. In accordance with the Code, the Director 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 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. 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). Including 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.

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 contained in the table in section 32 of Appendix B.

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.	£0
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 accrue if the bond is sold before maturity.	£0
c.	**Eligible Institutions** - the organisation is an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 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.	£5m
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.	£2m
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 and have a minimum asset size of £*250*m, but will restrict the	£5m or 1% of total assets

	amount of investments to 1% of its asset size.	
f.	Any **bank or building society** that has a minimum long term credit rating of A+/A, for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	Maximum limit of 100%, so long as no more than 25% of investments have maturities of longer than one year at any one time.
g.	Any **non rated subsidiary** of a credit rated institution included in the specified investment category. These institutions will be included as an investment category subject to having a minimum asset size of £250m, and a restriction on the investment amount to 1% of its asset size.	£5m for a maximum of 3 mths.
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	£0
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.	£0

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 Finance, and if required new counterparties which meet the criteria will be added to the list.

Annex B2

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 - £1.3m
- Liquid short term deposits of at least £1m 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:

- Current weighted average life of an investment is expected to be 0.45 years, with a maximum of 2.77 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 beneath 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:

- 0.05% 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	0.05%	0.04%	0.03%	0.02%	0.01%

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 Standing Orders/Financial Regulations/Constitution

1. This Council will create and maintain, as the cornerstones for effective treasury management:
   - A treasury management policy statement (TMP), 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, 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 Executive to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.