AGENDA ITEM NO: 4

HAMBLETON DISTRICT COUNCIL

Report To: Cabinet
20 March 2012

Subject: **TREASURY MANAGEMENT STRATEGY AND ANNUAL INVESTMENT STRATEGY 2012/13**

All Wards
Audit and Governance Committee
Cabinet Member for Corporate Management: Councillor R Kirk

1.0 PURPOSE AND BACKGROUND:

1.1 The purpose of this report is to present to Cabinet for approval the proposed Treasury Management Strategy for 2012/13 – attached as Appendix 1. The Strategy also incorporates the latest requirements set out by the Department for Communities and Local Government (DCLG) in terms of the Annual Investment Strategy.

1.2 In broad terms a Treasury Management Strategy sets out a framework for how the Council will manage its investments, cash flows and borrowings. Specifically a treasury management strategy:

- Sets out the legal and Code of Practice requirements for treasury management
- Identifies reporting arrangements and responsibilities
- Clearly states that the Council's priorities for investment are the security of capital and the liquidity of its investments
- Identifies the type and the limits for investments and counterparties with which those investments can be placed as well as the maximum duration of the investment

1.3 Approval of the Treasury Management Strategy is required by the Council's constitution as recommended by the Chartered Institute of Finance and Accountancy's Code of Practice on Treasury Management 2009.

2.0 SUMMARY OF PROPOSED STRATEGY:

2.1 The proposed Strategy for 2012/13 reflects the improved stability of the banking sector and the support given by national governments, as well as a more risk averse approach to the system of credit ratings. The proposed Strategy can be summarised as follows:

- A continuation of the Council's investment priorities being security of capital and liquidity of its funds, whilst maximising returns commensurate with risk;
- Only investments of less than a year will be made in order to preserve liquidity and react should there be an increase in interest rates
- Allows unlimited deposits to be made with the Debt Management Agency Deposit Facility
- Allows deposits to be made to other local authorities, nationalised banks and banks which are part of the UK banking system support package
- Allows deposits to be made to other UK Banks and Building Societies, subject to the application of Sector's credit worthiness criteria

- Allows deposits in foreign banks and institutions of AAA sovereign rated countries subject again to Sectors credit worthiness criteria
- Applies limits for investments in foreign countries and banking groups

3.0 DECISIONS SOUGHT:

3.1 Approval is sought for the Treasury Management Strategy for 2012/13 as set out in Appendix 1of this report.

4.0 RISK MANAGEMENT:

4.1 Treasury Management is about taking the correct decisions in an ever changing environment. To that end risk is inherent in the process. However, the Treasury Management Strategy seeks to minimise this risk to the Council's reserves through market, interest rate and credit risks. The Strategy will be kept under constant review and a report brought back to Cabinet should it require changing.

5.0 RECOMMENDATION:

5.1 It is recommended to Council that the Treasury Management Strategy (including the Annual Investment Strategy) for 2012/13 be approved.

DAVE SIMPSON

Background papers: None

Author ref: DS

Contact: Dave Simpson
Head of Finance and S.151 Officer
Direct Line No: 767024

APPENDIX 1

TREASURY MANAGEMENT STRATEGY STATEMENT, MRP STRATEGY and ANNUAL INVESTMENT STRATEGY 2012/13

1.0 INTRODUCTION:

1.1 Background

1.1.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

1.1.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

1.1.3 CIPFA defines treasury management as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks. "

1.2 Reporting Requirements

1.2.1 The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals. These reports are required to be adequately scrutinised by Members before being recommended to the Council. This role is undertaken by Cabinet.

Prudential and Treasury Indicators and Treasury Strategy (This report)

1.2.2 The first, and most important report covers:

- the capital plans (including prudential indicators);
- a Minimum Revenue Provision Policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A Mid Year Treasury Management Report

1.2.3 This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision.

An Annual Treasury Report

1.2.4 This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

1.3 Treasury Management Strategy for 2012/13

1.3.1 The strategy for 2012/13 covers two main areas:

Capital Issues

- the capital plans and the prudential indicators
- the Minimum Revenue Provision (MRP) strategy

Treasury Management Issues

- the current treasury position
- treasury indicators which will limit the treasury risk and activities of the Council
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy
- credit worthiness policy
- policy on use of external service providers

1.3.2 These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the CLG MRP Guidance, the CIPFA Treasury Management Code and the CLG Investment Guidance.

2.0 THE CAPITAL PRUDENTIAL INDICATORS 2012/13 – 2014/15:

2.1 The Council's capital expenditure plans are the key driver of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist Members overview and confirm capital expenditure plans.

Capital Expenditure

2.2 This prudential Indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts.

Capital Expenditure £000	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Non-HRA	1,570	3,709	2,185	569	620
HRA	-	-	-	-	-
Total	**1,570**	**3,709**	**2,185**	**569**	**620**

2.3 Other long term liabilities. The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments. The Council has no PFI schemes.

2.4 The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing).

Capital Expenditure £000	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Non-HRA	1,570	3,709	2,185	569	620
HRA	-	-	-	-	-
Total	**1,570**	**3,709**	**2,185**	**569**	**620**
Financed by:					
Capital receipts	750	3609	2085	469	520
Capital grants	805	100	100	100	100
Capital reserves	-	-	-	-	-
Revenue	15	-	-	-	-
Net financing need for the year	**-**	**-**	**-**	**-**	**-**

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

2.5 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic 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. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

2.6 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 £555,410 of such schemes within the CFR.

2.7 The Council is asked to approve the CFR projections below:

£000	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Capital Financing Requirement					
CFR – non housing	555	84	-	-	-
CFR - housing	-	-	-	-	-
Total CFR	**555**	**84**	**-**	**-**	**-**
Movement in CFR	**(471)**	**(471)**	**(84)**	**-**	**-**

Movement in CFR represented by					
Net financing need for the year (above)	(471)	(471)	(84)	-	-
Less MRP/VRP and other financing movements	-	-	-	-	-
Movement in CFR	**(471)**	**(471)**	**(84)**	**-**	**-**

Note the Minimum Revenue Provision / Voluntary Revenue Provision includes finance lease annual principal payments

MRP Policy Statement

2.8 The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

2.9 CLG Regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to Councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement*:*

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 outlined in former CLG regulations (option 1); *or*
- **Based on CFR** – MRP will be based on the CFR (option 2);

These options provide for an approximate 4% reduction in the borrowing need (CFR) each year. This Council approves option 2.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be *(either / and):*

- **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 Direction) (option 3);
- **Depreciation method** – MRP will follow standard depreciation accounting procedures (option 4);

These options provide for a reduction in the borrowing need over approximately the asset's life. This Council approves option 3.

2.10 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.

2.11 Repayments included in annual PFI or finance leases are applied as MRP.

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

2.12 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	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Fund balances / reserves	17,388	17,178	16,967	16,491	15,892
Capital receipts	5,035	4,277	3,402	3,506	2,986
Provisions	434	434	434	434	434
Other	-	-	-	-	-
Total core funds	**22,857**	**21,889**	**20,803**	**20,431**	**19,312**
Working capital*	(84)	-	-	-	-
Under/over borrowing	-	-	-	-	-
Expected investments	**22,773**	**21,889**	**20,803**	**20,431**	**19,312**

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

Affordability Prudential Indicators

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

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.

%	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Non-HRA	-	-	-	-	-
HRA	-	-	-	-	-

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

Estimates of the incremental impact of capital investment decisions on council tax. This indicator identifies the revenue costs associated with proposed changes to the three year capital programme 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.

Incremental impact of capital investment decisions on the band D council tax

£	2009/10 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Council tax - band D	£4.21	£5.43	£3.87	£5.28	£7.62

3.0 TREASURY MANAGEMENT STRATEGY:

3.1 The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.2 Current Portfolio Position

3.2.1 The Council's treasury portfolio position at 31 March 2011, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£m	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
External Debt					
Debt at 1 April	-	-	-	-	-
Expected change in Debt	-	-	-	-	-
Other long-term liabilities (OLTL)	1,026	555	84	-	-
Expected change in OLTL	(471)	(471)	(84)	-	-
Actual debt at 31 March	**555**	**84**	**-**	**-**	**-**
The Capital Financing Requirement	**555**	**84**	**-**	**-**	**-**
Under / (over) borrowing	**-**	**-**	**-**	**-**	**-**

Total investments at 31 March					
Investments	**22,773**	**21,889**	**20,803**	**20,431**	**19,312**
Investment change	(884)	(1,086)	(372)	(1,119)	-

Net Debt (Net Investment)	**(22,218)**	**(21,805)**	**(20,803)**	**(20,431)**	**(19,312)**

3.2.2 Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its total debt, 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 2012/13 and the following two financial years (shown as net borrowing above). This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

3.2.3 The Chief Finance Officer 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.

3.3 **Treasury Indicators: Limits to Borrowing Activity**

3.3.1 **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 Estimate**	**2012/13 Estimate**	**2013/14 Estimate**	**2014/15 Estimate**
Debt	4,000	4,000	4,000	4,000
Other long term liabilities	600	600	600	600
Total	**4,600**	**4,600**	**4,600**	**4,600**

3.3.2 **The Authorised Limit for external debt.** A further key prudential indicator represents a control on the maximum level of debt. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the 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.

1. 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 this power has not yet been exercised.
2. The Council is asked to approve the following Authorised Limit:

Authorised limit £000	**2011/12 Estimate**	**2012/13 Estimate**	**2013/14 Estimate**	**2014/15 Estimate**
Debt	5,000	5,000	5,000	5,000
Other long term liabilities	1,000	1,000	1,000	1,000
Total	**6,000**	**6,000**	**6,000**	**6,000**

3.4 **Prospects for Interest Rates**

3.4.1 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. The following table gives the Sector central view.

Annual Average %	**Bank Rate**	**Money Rates**		**PWLB Borrowing 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

3.4.2 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.

3.4.3 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.

3.4.4 This challenging and uncertain economic outlook has a several key treasury mangement 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

3.5 **Borrowing Strategy**

3.5.1 The Council is currently debt free and it is anticipated that there will be no capital borrowings required during 2012/13. However, the Council will always endeavour to finance its capital programme in the most economically advantageous way and will consider all options including borrowing. Should borrowing become a preferred option, a report will be brought to Members.

Treasury Management Limits on Activity

3.5.2 There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any 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. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;

- Maturity structure 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.

3.5.3 The Council is asked to approve the following treasury indicators and limits:

£000	2012/13	2013/14	2014/15
Interest rate Exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	Nil	Nil	Nil
Limits on variable interest rates based on net debt	Nil	Nil	Nil
Maturity Structure of fixed interest rate borrowing 2012/13			
		Lower	**Upper**
Under 12 months		0%	0%
12 months to 2 years		0%	0%
2 years to 5 years		0%	0%
5 years to 10 years		0%	0%
10 years and above		0%	0%
Maturity Structure of variable interest rate borrowing 2012/13			
		Lower	**Upper**
Under 12 months		0%	0%
12 months to 2 years		0%	0%
2 years to 5 years		0%	0%
5 years to 10 years		0%	0%
10 years and above		0%	0%

3.6 Policy on Borrowing in Advance of Need

3.6.1 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.

3.6.2 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.

3.7 Debt Rescheduling

3.7.1 The Council has no debt outstanding and therefore does not require to consider debt rescheduling as part of this Strategy.

3.8 **Annual Investment Strategy**

3.8.1 **Investment Policy**

3.8.2 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.

3.8.3 In accordance with guidance from the CLG and CIPFA, 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, watches and outlooks published by all three ratings agencies with a full understanding of what these reflect in the eyes of each agengy. 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.

3.8.4 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 fully integrated into the credit methodology provided by the advisors, Sector in producing its colour codings which show the varying degreees of creditworthiness.

3.8.5 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.

3.8.6 The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable divesification and thus avoidance of concentration risk.

3.8.9 The intention of the strategy is to provide security of investment and minimisation of risk.

3.8.10 Investment instruments identified for use in the financial year are listed in Annex 1 under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules. Currently these limits are:

- **Individual Limits** – These limits will be set at 20% of total investments or £3.0m per counterparty whichever is the lower. One exception to this policy is with the Debt Management Agency Deposit Facility where the policy will be an unlimited amount with this organisation due to its high level of security. This policy will remain in force during 2012/13. For clarity, any investment with a Money Market Fund (MMF) will be regarded as being with one counterparty.

- **Group Limits** – this policy recognises that individual counterparties (banks/financial institutions etc), whilst being sound in themselves, may be part of a larger group. This brings with it added risks where parent institutions may be in difficulties. However, if the group limit was the same as the individual limit it would be too restrictive for the placing of investments when applied to our list of approved counterparties. This policy therefore sets the group limit at 40% of fund value. Individual limits for any counterparty within the group will be as stated above.

3.9 **Creditworthiness policy**

3.9.1 This Council applies the creditworthiness service provided by Sector. This service employs a sophisticated modelling approach utlilising credit ratings from the three main credit rating agencies - Fitch, Moodys and Standard and Poors. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

3.9.2 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the duration for investments. The Council will therefore use counterparties within the following durational bands*:*

- Yellow 5 years *
- Purple 1 year (Sector recommends 2 years, but this Council will restrict investments to 1 year
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No Colour not to be used

* *this category is for AAA rated Government debt or its equivalent..*

3.9.3 The Sector creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

3.9.4 Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of Short Term rating F1, Long Term rating A-, Viability ratings of BB+, and a Support rating of 3. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

3.9.5 All credit ratings will be monitored weekly. The Council is alerted daily to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

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

3.10 **Country Limits**

3.10.1 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AAA from Fitch (or equivalent). The list of countries that qualify using this credit criteria as at the date of this report are shown in Annex 2. The list includes lower rated countries for information. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

3.10.2 The Council has also determined that, other than the United Kingdom where no limit will apply, a maximum of 20% of total investments or £3.0m whichever is the lower will be invested in a single institution of a AAA sovereign rated country.

3.10.3 In addition, this policy restricts the total of investments in foreign countries to 40% of the total investments.

3.11 **Investment Strategy**

3.11.1 **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).

3.11.2 **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/ 2012 0.50%
- 2012/ 2013 0.50%
- 2013/ 2014 1.25%
- 2014/ 2015 2.50%

3.11.3 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.

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

2012/13	0.70%
2013/14	1.00%
2014/15	1.60%
2015/16	3.30%
2016/17	4.10%

Note: The estimated budget above for 2012/13 of 0.70% assumes that Bank Rate starts increasing from quarter 3 of 2013. There is downside risk to this forecast i.e. that the start of increases in Bank Rate is delayed even further if economic growth is weaker than expected. There is also upside risk if the MPC decides it needs to start increasing Bank Rate to defend its credibility in containing inflation and inflation expectations of the public.

3.11.5 **Invesment 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.

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

Maximum principal sums invested > 364 days			
£000	**2012/13**	**2013/14**	**2014/15**
Principal sums invested > 364 days	£12.5m	£11.5m	£11m

3.11.7 For its cash flow generated balances, the Council will seek to utilise its business reserve accounts, 15 and 30 day notice accounts and money market funds in order to benefit from the compounding of interest.

3.12 **End of Year Investment Report**

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

3.13 **Policy on the Use of External Service Providers**

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

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

3.13.3 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.

3.14 **Scheme of Delegation**

3.14.1 See Annex 3.

3.15 **Role of the Section 151 Officer**

3.15.1 See Annex 4.

LIST OF ANNEXES

1. Treasury Management Practices – Specified and Non Specified Investments and Limits

2. Approved Countries for Investments

3. Treasury Management Scheme of Delegation

4. The Treasury Management Role of the Section 151 Officer

ANNEX 1

TREASURY MANAGEMENT PRACTICE – TMP1
CREDIT AND COUNTERPARTY RISK MANAGEMENT
- SPECIFIED AND NON-SPECIFIED INVESTMENTS AND LIMITS

1.0 SPECIFIED INVESTMENTS:

1.1 All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' quality criteria where applicable.

2.0 NON-SPECIFIED INVESTMENTS:

2.1 These are any investments which do not meet the Specified Investment criteria. A maximum of 80% will be held in aggregate in non-specified investment

3.0 INVESTMENT INSTRUMENTS:

3.1 A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made, it will fall into one of the above categories.

3.2 The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

A) – SPECIFIED

Term Deposits with the DMADF, English Local Authorities, Banks and Building Societies

	Minimum 'High' Credit Criteria	Use
Debt Management Agency Deposit Facility	This is not credit rated, but is Govt-backed	In-house
Term deposits – English local authorities	This is not credit rated but LA's represent high security investment	In-house and by external fund managers (if employed)
Term deposits – Banks and Building Societies	Deposits will be placed only with credit rated institutions and for a period of time determined by Sector's Credit Rating Guidance dated December 2009. The colour coding applicable will be as per the "CDS Adjusted" column. The maximum period will be 1 year,	In-house and by external fund managers (if employed)

Term Deposits with Nationalised Banks, and Banks and Building Societies

Term deposits – banks and building societies	**Minimum Credit Criteria**	**Use**	**Max % of total investments ***	**Max. maturity period ****
UK part nationalised Banks	UK sovereign rating – colour blue	In-house and fund managers (if employed)	100%	1 year
Banks part nationalised by AAA rated (sovereign rated) countries – non UK	Sovereign rating of AAA – colour orange or blue	In-house and fund managers (if employed)	40%	1 year

* The maximum amount of funds that may be held in this type of deposit. Limits for individual counterparties are set out in the Council's Treasury Management Practices (TMP's) – £3.0m or 20% of fund value whichever is the lower

** If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate

B) – NON-SPECIFIED

A maximum of 80% (including both in-house and externally managed funds, if fund manager employed) will be held in aggregate in non-specified investments

1. Maturities under 1 Year

	Minimum Credit Criteria	**Use**	**** Max % of total investments**	*** Max. maturity period**
Certificates of deposits issued by banks and building societies covered by UK Government (explicit) guarantee	Deposits will be placed only with credit rated institutions and for a period of time determined by Sector's Credit Rating Guidance. The colour coding applicable will be as per the "CDS Adjusted" column.	In-house and by Fund Managers (if employed)	80%	1 year
UK Government Gilts	UK sovereign rating	In-house on a 'buy-and-hold' basis. Also for use by fund managers (if employed)	30%	1 year
Bonds issued by multilateral development banks	Long term AAA	In-house on a 'buy-and-hold' basis. Also for use by fund managers (if employed)	30%	1 year
Bonds issuance issued by a financial institution explicitly	UK sovereign rating	In-house on a 'buy-and-hold' basis. Also for	10%	1 year

guaranteed by the UK government (refers solely to GEFCO – Guaranteed Export Finance Corporation)		use by fund managers (if employed)		
Sovereign bond issues (other than the UK govt)	Sovereign rating - AAA	In-house on a ‘buy-and-hold’ basis. Also for use by fund managers (if employed)	10%	1 year
Treasury Bills [*Government debt security with a maturity less than one year and issued through a competitive bidding process at a discount to par value*]	UK Government This is lending to the Govt and is not credit rated, but is Govt-backed	In-house and external fund managers (if employed) subject to the guidelines and parameters agreed with them	30%	1 year

* If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate.

** Max % is calculated as maximum of all funds (ie specified and non specified)

2. Maturities in excess of 1 year

	* Minimum Credit Criteria	Use	** Max % of total investments	Max. maturity period
Term deposits – local authorities	This is not credit rated but LA’s represent high security investment	Do not use	50%	3 years
Term deposits – banks and building societies	Deposits will be placed only with credit rated institutions and for a period of time determined by Sector’s Credit Rating Guidance. The colour coding applicable will be as per the “CDS Adjusted” column.	Do not use	50%	2 years
Certificates of Deposit issued by banks and building societies covered by UK Government (explicit or implicit) guarantee	Deposits will be placed only with credit rated institutions and for a period of time determined by Sector’s Credit Rating Guidance dated December 2009. The colour coding applicable will be as per the “CDS Adjusted” column.	Do not use	50%	2 years
UK Government Gilts	UK sovereign rating	Do not use	30%	10 years
Bonds issued by multilateral development banks	Sovereign rating - AAA	Do not use	10%	10 Years

Bonds issued by a financial institution which is guaranteed by the UK government	UK sovereign rating	Do not use	10%	10 Years
Sovereign bond issues (i.e. other than the UK govt)	Sovereign rating - AAA	Do not use	10%	10 Years

* Based on the Council's minimum credit criteria using the Fitch Ratings matrix
** Max % is calculated as maximum of all funds (ie specified and non specified)

3. Maturities of ANY period.

	Minimum Credit Criteria	**Use**	**Max % of total investments**	**Max. maturity period**
Fixed term deposits with variable rate and variable maturities: - **1. Callable Deposits** **2. Range trade** **3. Snowballs**	Not applicable	Do not use	Nil	-
(if using) **Term deposits** with unrated counterparties : any maturity	Not applicable	Do not use	Nil	-
Commercial paper issuance covered by a specific UK Government (explicit) guarantee and issued by banks covered by the UK bank support package	UK Government explicit guarantee	Do not use	Nil	-
Commercial paper issuance by UK banks covered by UK Government (implicit) guarantee	UK Government implicit guarantee	Do not use	Nil	-
Corporate Bonds issuance covered by UK Government (implicit) guarantee and issued by banks covered by the UK bank support package: ***the use of these investments would constitute capital expenditure***	UK Government implicit guarantee	Do not use	Nil	-
Corporate Bonds other: ***the use of these investments would constitute capital expenditure***	Not applicable	Do not use	Nil	-
Other debt issuance by UK banks covered by UK Government (explicit) guarantee	UK Government explicit guarantee	Do not use	Nil	-
Floating Rate Notes : ***the use of these investments would constitute capital***	Not applicable	Do not use	Nil	-

expenditure unless they are issued by a multi lateral development bank				
Property fund: ***the use of these investments would constitute capital expenditure***	Not applicable	Do not use	Nil	-

ANNEX 2

APPROVED COUNTRIES FOR INVESTMENT
Current List as at 14 February 2012

Sector Treasury Services has advised that each Council should only use approved counterparties from countries with a minimum sovereign credit rating determined by the Council. This Council has determined that it will only use those countries with the highest sovereign rating of AAA. This list will be monitored at least weekly (and for information purposes only includes other sovereign ratings)

Based on lowest available rating

AAA

- **Australia**
- **Canada**
- **Denmark**
- **Finland**
- **Germany**
- **Luxembourg**
- **Netherlands**
- **Norway**
- **Singapore**
- **Sweden**
- **Switzerland**
- **U.K.**

AA+

- France
- Hong Kong
- U.S.A.

AA

- Belgium
- UAE

AA-

- Japan
- Qatar
- Saudi Arabia

ANNEX 3

TREASURY MANAGEMENT SCHEME OF DELEGATION

(i) Full Council

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

(ii) Cabinet

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

(iii) Audit and Governance Committee

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

ANNEX 4

THE TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER

The S151 Officer

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