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AUDIT COMMITTEE 8 FEBRUARY 2013

TREASURY MANAGEMENT STRATEGY 2013/14 – 2015/16

1. INTRODUCTION

1.1 The treasury management service (borrowing and investments) is an important part of the overall financial management of the Council's affairs.

1.2 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). This Council adopted the Code of Practice on Treasury Management on 25 February 2002.

1.3 A key requirement of the annual strategy report is to explain both the risks, and the management of the risks, associated with the treasury service. Mid-year monitoring reports and a year-end report on actual activity for the year are also required.

1.4 The Strategy as set out is intended to reflect the "working" strategy of the Council. The conformation of this strategy in accordance with the appropriate Code of Practice will be reported to Cabinet and Council.

1.5 Attached at Appendix A to this report is the full Treasury Management Strategy Report for 2013/14, to be submitted to the Council.

2. EXTERNAL BORROWING PLANS

2.1 The Council has no plans for new external borrowing next year or in the medium term. Any borrowing that would be undertaken would be temporary and for emergency or cash flow purposes.

2.2 Borrowing currently being managed relates to the Housing Revenue Account settlement debt and is summarised as follows:

Operational limit for external debt	2012/13 Revised £m	2013/14 Estimate £m	2014/15 Estimate £m	2015/16 Estimate £m
Temporary Borrowing (Limited to £30M)	0	0	0	0
Long - Term Borrowing	142.7	142.7	142.7	142.7
Total Borrowing Limit	142.7	142.7	142.7	142.7

3. EXTERNAL INVESTMENT PLANS

3.1 Background

3.1.1 The Council investments consist of two elements. Its "core funds" (reserves etc) and funds derived from the Council's "cash flow" (council tax, business rates and grant held funds retained temporarily until either expended or transferred to another body).

3.1.2 Core Funds are estimated to be in the region of £18 to £20 million and are tangible reserves, held on average for in excess of 1 year. Over the medium term the holding of core funds is likely to reduce as the Council delivers on its plans for expenditure.

3.1.3 “Cash flow” funds vary from day to day and are at their lowest at the end of March each year. On a monthly basis core funds and cash flow funds peak at circa £45 million, and average at circa £30 million. This indicates that approximately £15 million is held on average for less than a month and circa £10 to £15 million is held on average for less than a year.

3.2 Key Investment Objectives

3.2.1 The key investment priority is given to security and liquidity before yield.

3.2.2 The Council does however seek to achieve a reasonable yield that is available to support services. It therefore adopts a proactive approach to its investments. To support this approach a plan is being developed to enable “core funds” to achieve a “best” annual return on yield.

3.2.3 The strategy recognises that “Failures can and do happen” therefore the approach is to manage an acceptable level of risk.

3.3 Investment Risk Management

3.3.1 The Council is supported by external advisors (currently Sector) and uses all three credit rating agencies, Moody’s, Standard & Poors and Fitch, to determine which counterparties to use.

3.3.2 The rating criterion considered by this Council uses the **lowest common denominator** method of selecting counterparties and applying limits. This means that the Council will apply the minimum criteria available for the rating of any institution.

3.3.3 Credit rating information is supplied by the Council’s treasury consultants on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria is omitted from the authorised 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 making investments.

3.3.4 All deposits should be with organisations that have category 1 support from their Sovereign Government.

3.3.5 Organisations should have a minimum Long–Term rating of A.

3.3.6 At the time that the deposit is made the Credit Default Swap (CDS) prices will be determined to ensure that the market’s perception of the organisation is considered.

3.3.7 The credit rating of counterparties is monitored regularly, as a policy at least monthly. However the Council receives credit rating advice from its advisers, on a daily basis as and when ratings change, and counterparties are checked promptly.

3.3.8 Given that "Failures can and do happen" the diversification of counterparties is also important to managing risk. Based upon "Core Funds" reflecting reserves, 20% to 30% would be a moderate exposure. This would indicate that the maximum investment with any one counterparty would be in the range of £4 million to £6 million. See

Appendix B.

3.3.9 However, it is reasonable to suggest that investments with organisations which are deemed to be the "safest" are given higher investment values. The value of investments with the UK Government is unlimited and with AAA rated Money Market Funds is £10m per fund.

4. ENVIRONMENTAL IMPLICATIONS

There are no environmental implications arising from this report.

5. CRIME AND DISORDER IMPLICATIONS

There are no crime and disorder implications arising from this report.

6. CONCLUSIONS

6.1 The Council will only borrow for short term cash flow requirements in 2013/14.

6.2 The Council is formulating a plan to optimise yield but also recognising an acceptable level of risk.

6.3 Parameters are allocated to investment counterparties that will be the basis of the Investment Strategy for 2013/14.

7. RECOMMENDATIONS

7.1 That the Committee endorse the informal arrangement where members meet the Section 151 Officer to monitor and advise on the Treasury Management function against the Treasury Management Strategy and report to the Committee on a quarterly basis on progress.

7.2 That it be a recommendation to the Council that the Treasury Management Investment Strategy for 2013/14 be approved as set out in Appendix A to this report.

Further Information
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Background Papers
Published Papers

AUDIT COMMITTEE - 8 FEBRUARY 2013

TREASURY MANAGEMENT STRATEGY REPORT 2013/14

1. INTRODUCTION

The Prudential Code for Capital Finance in Local Authorities (The Code) was introduced with effect from 1 April 2004. The Code gives the Council greater freedom for future capital investment plans.

This report outlines the Council's prudential indicators for 2013/14 – 2015/16 and sets out the expected treasury operations for this period. It fulfils four key legislative requirements.

2. POLICIES AND APPROVALS REQUIRED

2.1 Prudential Indicators

The Council must approve, revise and monitor a minimum number of mandatory prudential indicators setting out the expected capital activities.

The indicators cover the affordability, sustainability and prudence of capital expenditure, external debt and the Council's treasury and investment strategies for each financial year.

The purpose of the indicators is to provide Members with an overview for capital expenditure decision making. It highlights the level of capital expenditure and the impact of that expenditure on borrowing and investment levels, which will affect the treasury management strategy for future years.

The main prudential Indicators are shown at Annex A.

2.2 Minimum Revenue Provision (MRP) Policy

The Council's Minimum Revenue Provision (MRP) Policy sets out how the Council will pay, when necessary, for General Fund capital assets through revenue each year.

Each year's capital expenditure programme is financed by using a variety of sources. If those resources are insufficient to pay for the full programme there will be a borrowing need. Each year the programme generates a General Fund borrowing requirement and this is the amount of loan that the Council may have to raise to adequately fund the programme. This borrowing requirement can also be met by using cash reserves and therefore deferring the raising of loans until a later date, which is the current position for this Council.

Loans can be raised in advance or in arrear of generating the borrowing requirement. The most beneficial time to raise loans will depend on prevailing interest rates and the Executive Director, under delegated powers, will determine the most beneficial form of borrowing at the most advantageous time.

The MRP Policy Statement is shown at Annex A.

2.3 Treasury Management Strategy Statement

The Treasury Management Strategy Statement sets out how the Council's treasury service will support the capital expenditure and financing decisions taken over the three year period from 2013/14 to 2015/16. The day to day treasury management function and the limitations on activity through treasury prudential indicators are also set out in the statement.

The key indicator is the **Authorised Limit for External Debt**. This is the maximum amount of debt the Council could afford in the short term, but which would not be sustainable in the longer term. This is in accordance with the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code and shown at Annex B, paragraph 3.3;

The indicators for 2013/14 must be agreed prior to 1 April 2013. In addition, the indicators for the following 2 years are also estimated. This informs Members of the treasury management requirements of the estimated capital expenditure and the implications of this expenditure in the medium term.

2.4 Investment Strategy

The Council's investment policy has regard to the CLG's Guidance on Local Government Investments and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes.

The investment strategy sets out the Council's criteria for choosing investment counterparties and limiting exposure to the risk of loss.

This strategy is shown in Annex B.

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

This report informs Members of the treasury strategy and recommends the Treasury prudential indicators for 2013/14 to 2015/16.

3. Recommendations

The Audit Committee is recommended to request Council to approve each of the key elements of these reports:

3.1 The Prudential Indicators and Limits for 2013/14 to 2015/16 contained within Annex A of the report, including the Authorised Limit prudential indicator.

3.2 The Minimum Revenue Provision (MRP) Policy Statement contained within Annex A which sets out the Council's policy on MRP.

3.3 The Treasury Management Strategy 2013/14 to 2015/16, and the treasury Prudential Indicators contained within Annex B.

3.4 The Investment Strategy 2013/14, including the 2011 revised CIPFA Code of Practice, contained in the Treasury Management Strategy (Annex B), and the detailed criteria included in Annex B1.

Further Information

Please contact Jan Hawker, Treasury Management Accountant Ext. 284444
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Background Papers

The Prudential Code, CIPFA Guidance Notes and CLG Investment Guidance.

General Fund Revenue Budget and Capital Programme 2013/14 (on this agenda)

ANNEX A

THE CAPITAL PRUDENTIAL INDICATORS 2013/14 – 2015/16

1. CAPITAL EXPENDITURE AND CAPITAL FINANCING REQUIREMENT

1.1 Each year the Council approves a programme of capital expenditure. Some of this expenditure will be supported by grants and contributions from the Government and other organisations; the remainder will need to be financed from the Council's own sources. If this expenditure cannot be financed from resources such as capital receipts, capital reserves or from direct revenue contribution there will be an impact on the Council's underlying need to borrow.

1.2 This underlying need to borrow is called the Capital Financing Requirement (CFR).

1.3 The revenue consequences of capital expenditure funded by borrowing will need to be paid for from the Council's revenue resources. This is called the Minimum Revenue Provision (MRP).

1.4 The key risks to the plans are that the level of Government support has been estimated and 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.

1.5 In 2012/13 the Council borrowed £142.7m to meet the requirements of the HRA reform. The indicators also reflect this ongoing level of debt as none is due for repayment in the immediate future.

2. CAPITAL EXPENDITURE

2.1 The capital expenditure projections and the CFR are shown below. A more detailed schedule for these projections is included in the main budget report on this agenda.

This is the first prudential indicator and the Council is asked to approve the summary capital expenditure projections below.

Capital Expenditure	2012/13 Revised £000	2013/14 Estimate £000	2014/15 Estimate £000	2015/16 Estimate £000
Non-HRA	10,483	8,198	5,493	6,099
HRA	12,305	13,043	11,488	11,488
Total Expenditure	**22,788**	**21,241**	**16,981**	**17,587**
Financed by:				
Capital receipts	212	1,320	742	742
Capital grants	2,667	4,305	2,413	3,021
Capital reserves	1,051	500	350	348
Developers Contributions	2,339	613	0	0
Revenue	13,706	12,378	11,488	11,488
Net capital financing requirement (CFR)	**2,813**	**2,125**	**1,988**	**1,988**

3. CAPITAL FINANCING REQUIREMENT

3.1 Capital expenditure will impact directly on the overall CFR if there is a borrowing requirement (see 2.1 above). For the purposes of this report any assumed borrowing requirement is met by using cash held in reserves, rather than raising loans. This action is the expressed preference of Members. In reality consideration can be given to raising loans from external organisations rather than using the cash held in the Council's reserves depending on the forecast of interest rates over the medium term and the Council's internal cash flow.

3.2 The loans raised to meet the payment required for the HRA housing reform settlement in March 2012 also now forms part of the CFR.

3.3 The CFR is reduced by the amount of any provision that is made to repay loan in the future. This provision is known as the MRP.

3.4 The cumulative net projections for the CFR at each year-end are shown below. This is the second prudential indicator.

3.5 The Cabinet is asked to approve the CFR projections below.

Capital Financing Requirement (CFR)	**2012/13 Revised £000**	**2013/14 Estimate £000**	**2014/15 Estimate £000**	**2015/16 Estimate £000**
CFR–Non Housing	5,508	5,720	5,845	6,017
CFR - Housing	1,897	1,897	1,897	1,897
HRA Settlement	142,704	142,704	142,704	142,704
Total CFR at year end	150,109	150,321	150,446	150,618
Movement in CFR from one year to the next		**212**	**125**	**172**
For each year the movement in CFR is represented by				
Net Financing Need (The amount of capital expenditure financed by loan)	2,813	2,125	1,988	1,988
HRA Settlement	0	0	0	0
MRP provision - (the amount by which any loan requirement is reduced)	-1,771	-1,913	-1,863	-1,816
Movement in CFR	**1,042**	**212**	**125**	**172**

4. MINIMUM REVENUE PROVISION

4.1 Where General Fund (excluding Council Housing) capital spend has been financed by loan and has increased the CFR the Council is required to make a provision to repay a proportion of the accumulated amount each year. This amount is charged to revenue and is called the Minimum Revenue Provision (MRP). This charge reduces the CFR each year.

CLG Regulations have been issued which require full Council to approve an MRP Statement in advance of each financial year. The Council is recommended to approve the following MRP Statement:

"For capital expenditure that has been incurred and which has given rise to a CFR the MRP Policy shall be to charge to revenue an amount equal to the depreciation of any asset financed by loan".

For Council Housing the Council has approved currently a Housing Business Plan that will charge amounts to revenue to ensure that any borrowings are reduced in accordance with the maturity of the debt outstanding.

5. THE COUNCIL'S RESOURCES AND THE INVESTMENT POSITION

5.1 The use of reserves to finance capital expenditure will have an impact on investments unless resources are supplemented each year from sources such as asset sales. The following table shows estimates of year end balances for each resource and anticipated day to day cash flow balances. This table does not include the HRA Settlement debt in the CFR figure as this is actual debt as opposed to the use of internal resources.

Estimated Year End Resources	2012/13 Revised £m	2013/14 Estimate £m	2014/15 Estimate £m	2015/16 Estimate £m
Fund Balances	12.3	12.7	13.7	14.7
Capital Receipts	2.9	2.0	1.7	1.4
Earmarked Reserves	6.5	6.0	5.6	5.3
Total Core Funds	**21.7**	**20.7**	**21.0**	**21.4**
Temporary Cash Flow	8.7	6.8	5.1	3.3
Under (-) /Over Borrowing (CFR)	-7.4	-7.6	-7.7	-7.9
Investments at 31 March	**23.0**	**19.9**	**18.4**	**16.8**

Temporary Cash Flow is estimated at the year end and may be higher during the year.

6. AFFORDABILITY PRUDENTIAL INDICATORS

The previous sections cover the prudential indicators for capital expenditure and borrowing. This section assesses the affordability of the capital investment plans. These provide an indication of the impact of the capital programme on the Council's overall finances.

The Council is asked to approve the following indicators.

6.1 Ratio of financing costs to net revenue stream

6.1.1 The net revenue stream for the General Fund is the amount of revenue expenditure, arising from the capital program, which is met from government grant and council tax.

6.1.2 The net revenue stream for the Housing Revenue Account is the amount of revenue expenditure, arising from the capital program, which is met by rents.

6.1.3 The following table shows the cumulative incremental effect of the estimated financing cost, against the estimated net revenue stream. This assesses the cost of borrowing to the revenue account.

An example is set out below:	**2013/14**	
General Fund Financing cost	£167,000	= 0.9%
General Fund Net Revenue Stream	£19,337,000	

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

	2012/13 Revised	**2013/14 Estimate**	**2014/15 Estimate**	**2015/16 Estimate**
Non - HRA	0.2%	0.9%	-0.1%	0.1%
HRA (inclusive of settlement)	19.0%	0.0%	0.0%	0.0%

The financing cost in 2012/13 for the HRA is entirely due to the borrowing in respect of the HRA settlement. This will be met from the rents that are retained under the settlement arrangements. The figure for the HRA reduces to zero in 2013/14 because the figures show incremental movements from year to year. As the interest payable is at a fixed rate it will not vary until any repayments are made. No repayments are due for the life of this report.

6.2 Estimates of the incremental impact of capital investment decisions on the Band D Council Tax

6.2.1 This indicator shows the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The indicator shows the impact on the Council Tax of the revenue implications of the capital programme in isolation from any other expenditure that may generate a revenue charge.

	Proposed Budget 2013/14	**Forward Projection 2014/15**	**Forward Projection 2015/16**
Change to Council Tax-Band D	1.47%	-0.24%	0.08%
Change to Council Tax cost year on year	£2.30	-£0.37	£0.13

6.3 Estimates of the incremental impact of capital investment decisions on housing rent levels

6.3.1 The Council has adopted the Government's rent restructuring policy. As such, the unsupported element of the capital programme has no impact on rent levels.

6.3.2 The indicator below shows the cost of proposed changes in the housing capital programme, as recommended elsewhere on this agenda expressed as a change in weekly rent levels if the Government’s rent restructuring policy had not been adopted.

	Proposed Budget 2013/14	Forward Projection 2014/15	Forward Projection 2015/16
Change to Weekly Housing Rent levels	£0.31	-£3.37	£0.00

ANNEX B

TREASURY MANAGEMENT STRATEGY 2013/14 – 2015/16

1. INTRODUCTION

1.1 The treasury management service is an important part of the overall financial management of the Council's affairs. Whilst the prudential indicators in Annex A consider the affordability and impact of capital expenditure decisions, the treasury service covers the effective funding of these decisions. There are specific treasury prudential indicators included in this strategy that need approval. Together they form part of the process which ensures the Council meets its balanced budget requirement under the Local Government Finance Act 1992.

1.2 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). This Council adopted the Code of Practice on Treasury Management on 25 February 2002.

As a result of adopting the Code the Council also adopted a Treasury Management Policy Statement. This adoption is the requirement of one of the prudential indicators.

1.3 The Council's investment policy has regard to the CLG's Guidance on Local Government Investments and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes. The Council's investment priorities will be security first, liquidity second, then return.

1.4 The policy requires an annual strategy to be reported to Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. Three mid-year monitoring reports and a year-end report on actual activity for the year are also required.

1.5 The Executive Director (Section 151 officer), supported by the informal Members' Treasury Monitoring Panel, will report to the Audit Committee on a quarterly basis.

2. DEBT AND INVESTMENTS PROJECTIONS

2.1 The borrowing requirement comprises the expected movement in the CFR. In this Council's case the expected movement in the CFR represents the funding of capital expenditure by "borrowing" from internal funds and actual borrowing in respect of the HRA settlement.

2.2 The expected external maximum debt position during each year represents the Operational Boundary prudential indicator and so may be different from the year end position.

2.3 The expected impact of the capital expenditure decisions on the Council's gross debt and investment position are shown below:

	2012/13 Revised £m	2013/14 Estimated £m	2014/15 Estimated £m	2015/16 Estimated £m
External Debt				
Borrowing	142.7	142.7	142.7	142.7
Other Long-term Liabilities	0.0	0.0	0.0	0.0
Total Gross Debt at 31 March	**142.7**	**142.7**	**142.7**	**142.7**
Expected change in debt		0.0	0.0	0.0
Investments				
Total Gross Investments at 31 March	**-23.0**	**-19.9**	**-18.4**	**-16.8**
Expected change in Investments		3.1	1.5	1.6

The reduction in the investment balance between 2012/13 and 2013/14 of £3.1 million reflects the use of loan, capital receipts, developers' contributions, and capital reserves to finance capital purchases in 2013/14 (£4.6 million of investments), offset by the anticipated receipt of new sums of developers' contributions and capital receipts (£1.5 million).

3 LIMITS TO BORROWING ACTIVITY

3.1 External borrowing

The Council needs to make sure that external borrowing in 2013/14 does not exceed the total of the CFR at the end of 2013/14 and the two subsequent years. This allows some flexibility for limited borrowing in advance of the need to spend but assures that borrowing is not undertaken for revenue purposes.

External Borrowing	2012/13 Estimate £m	2013/14 Estimate £m	2014/15 Estimate £m	2015/16 Estimate £m
Gross Borrowing	142.7	142.7	142.7	142.7
CFR at year end	150.1	150.3	150.4	150.6
Safety Margin for Limit of Capital Expenditure to be Financed from Loan	**7.4**	**7.6**	**7.7**	**7.9**

As borrowing of £142.7 million in 2013/14 does not exceed the CFR in any year up to 2015/16 this indicator is satisfied. The Executive Director reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties in the future. This view takes into account current commitments, existing plans and the proposals in the budget report.

3.2 The Operational Boundary for External Debt

This is the limit beyond which external borrowing is not **normally** expected to exceed. It is anticipated that the only debt that will be raised in 2013/14 is short-term temporary debt to cover cash flow requirements. This is estimated to be for a very short time and the average for the year is negligible.

Operational limit for external debt	**2012/13 Revised £m**	**2013/14 Estimate £m**	**2014/15 Estimate £m**	**2015/16 Estimate £m**
Temporary Borrowing	0	0	0	0
Long - Term Borrowing	142.7	142.7	142.7	142.7
Total Borrowing Limit	**142.7**	**142.7**	**142.7**	**142.7**

3.3 The Authorised Limit for External Debt

This is the limit beyond which borrowing is **prohibited** and needs to be set by Members for each financial year. It reflects the level of borrowing that, while not desired or sustainable, could be required in the short-term. It is the maximum external borrowing required with some headroom for unexpected cash flow movements and includes both temporary borrowing for cash flow purposes and long term borrowing to finance capital expenditure and the HRA settlement.

Authorised limit for external debt	**2012/13 Revised £m**	**2013/14 Estimate £m**	**2014/15 Estimate £m**	**2015/16 Estimate £m**
Temporary Borrowing	30.0	30.0	30.0	30.0
Long - Term Borrowing	142.7	142.7	142.7	142.7
Total Borrowing Limit	**172.7**	**172.7**	**172.7**	**172.7**

3.4 The Maximum HRA Debt Limit

The Council is also limited to a maximum HRA CFR through the HRA self-financing regime. The Council may not borrow more than this limit for HRA purposes.

This limit is dictated by the DCLG and is based on the amount of the settlement payment of £142.7m plus the Housing Subsidy Notional Debt amount of £12.8m.

HRA Debt Limit	**2012/13 Revised £m**	**2013/14 Estimate £m**	**2014/15 Estimate £m**	**2015/16 Estimate £m**
Total	155.5	155.5	155.5	155.5

4. EXPECTED MOVEMENT IN INTEREST RATES

4.1 Medium-Term Rate Forecasts

The following table outlines the central view of the Council's treasury consultants at the end of each financial year.

Year	Base Rate	Money Market Rate			PWLB Borrowing Rate		
	%	3 Month %	6 Month %	1 Year %	5 year %	10-year %	25-year %
2012/13	0.5	0.5	0.7	1.0	1.5	2.5	3.8
2013/14	0.5	0.5	0.7	1.1	1.7	2.7	3.9
2014/15	0.8	0.8	1.1	1.3	2.2	3.2	4.3
2015/16	1.8	1.9	2.2	2.4	2.9	3.9	5.0

4.2 Bank Base Rate, currently 0.5%, underpins investment returns and is not expected to start increasing until quarter 1 of 2015 despite inflation remaining well above the Monetary Policy Committee inflation target currently. There is potential for the start of Bank Base Rate increases to be even further delayed if growth disappoints.

4.3 Growth is unlikely to increase significantly and an export led recovery appears unlikely due to the Eurozone sovereign debt crisis depressing growth in the UK's biggest export market.

4.4 Fixed interest borrowing rates are based on UK gilt yields. It is likely that the trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries.

5. BORROWING AND DEBT STRATEGY 2013/14 – 2015/16

5.1 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is high currently.

5.2 Against the economic background and the risks within the economic forecast, caution will continue to be adopted with the 2013/14 treasury operations. The uncertainty over the timing of future interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its borrowing strategy. The Executive Director will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances. Although the borrowing requirement is detailed by year it is not certain that any General Fund loans will be raised in the immediate future.

5.3 The Executive Director, supported by the informal Treasury Monitoring Panel, 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 at 4.1. This may include borrowing in advance for future years requirements if it is prudent to do so. However any risks associated with borrowing in advance will not be purely in order to profit and will be subject to prior appraisal and subsequent reporting through the regular mid-year or annual reports.

6. INVESTMENT STRATEGY 2013/14 – 2015/16

6.1 Key Objectives

The key intention of the investment guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield.

The current investment climate has one over-riding risk consideration; that of counterparty security risk. Although this risk has always been rigidly controlled global economic and banking events have heightened the consciousness of this risk. As a result the Executive Director implements an operational investment strategy. This tightens the controls already in place in the approved investment strategy. The operational investment strategy is reviewed regularly by the Executive Director supported by the informal Treasury Monitoring Panel.

6.2 Risk Benchmarking

Requirements in the Code are the consideration and approval of security and liquidity benchmarks.

Yield benchmarks are already widely used to assess investment performance. Security and liquidity benchmarks are requirements which must also be reported to Members. Yield benchmarking is factual whereas the application of security and liquidity benchmarking is subjective in nature. Additional background in the approach taken is attached at Annex B2.

These benchmarks are 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 Reports.

6.2.1 **Security**

The Council’s maximum security risk benchmark for the current portfolio, when compared to the historic default tables at Annex B2, is **0.07%.**

The security risk benchmark for each individual year is as follows:

	1 year	***2 years***	***3 years***	***4 years***	***5 years***
Maximum	*0.07%*	*0%*	*0%*	*0%*	*0%*

There is no risk for any duration of investment longer than one year currently as the Council is restricting investment to periods of one year or less because of the economic climate.

6.2.2 **Liquidity**

In respect of this area the Council seeks to maintain:

- Bank overdraft - £0.75m
- Weighted Average Life benchmark is expected to be approximately 200 days, with a maximum of 1 year.

In 2012/13 to date the weighted average life for investment periods is 189 days. It is likely that this will be similar, or slightly lengthened, for 2013/14.

6.2.3 Yield

Local measures of yield benchmarks are:

- Investments – returns above the 7 day LIBID rate

More information about risk benchmarking is provided as Annex B2.

6.3 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 that:

- It maintains a policy covering 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 at 6.4.2 to 6.4.3 below.

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed.

The Executive Director will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval if necessary.

6.4 Credit Ratings

6.4.1 A creditworthiness service is provided by the Council's Treasury Consultants. This service uses 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 information:

- 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.

The 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.

Credit rating information is supplied by the Council's treasury consultants on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria is omitted from the authorised 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 making investments.

6.4.2 **Specified and Non Specified Investments**

Specified investments are highly credit rated and highly liquid investments in sterling and with a maturity of no more than a year.

Non-specified investments identifies the greater risk implications of investments that are not so highly credit rated or are for a longer period than one year.

This Council is not considering investments for a longer duration that 1 year currently or with a less highly credit rated organisation. This strategy has been set to reflect this.

Therefore all investments made by this Council in 2013/14 are considered to be Specified Investments and these are approved under the new guidance and will form part of the Council's policy.

6.4.3 **Specified Investments**

These investments are made in sterling and have a duration of 1 year or less, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes.
These are low risk investments where the possibility of loss of principal or investment income is very low. Specified investments include:

	Minimum Credit Criteria	Sovereign Rating	Designated Risk	Approx. maximum % core investment	Approx. maximum % Temporary investment	Approx. Limit per Counter-party
Debt Management Agency Deposit Facility	Not Applicable	UK	Very Low	100%	100%	N/A
UK Local Authorities	Not Applicable	UK	Very Low	100%	100%	£6m
Money Market Funds	AAA	N/a	Very Low	100%	100%	£10m
UK Gov. part owned UK Banks	Not Applicable	UK	Low	30%	30%	£6m
Other UK High Street Banks & Building Societies	Short-Term F1	UK	Low	30%	30%	£6m
Other Highly rated Banks	Short-term F1+	AAA	Low	30%	30%	£6m
Other Highly rated Banks	Short-term F1	AAA	Moderate	15%	15%	£4m
Other Highly rated Banks	Short-term F1+	AA	Moderate	15%	15%	£4m

6.4.4 **The Council's own banker**

If the Council's own bank is below the above criteria the bank will still be used for normal banking transactions. However, balances held on account will be kept to a minimum working amount.

6.5 Other Criteria

6.5.1 All deposits should be with organisations that have category 1 support from their Sovereign Government.

6.5.2 Organisations should have a minimum Long-Term credit rating of A.

6.5.3 At the time that the deposit is made the Credit Default Swap (CDS) prices will be determined to ensure that the market's perception of the organisation is considered.

6.5.4 When applying the percentage rule as shown in the table at 6.4.3 above, should the total sum invested be less than £2.5m, then the maximum investment with any one organisation may be £500,000.

6.6 The Monitoring of Investment Counterparties

The credit rating of counterparties will be monitored regularly, as a policy at least monthly. However the Council receives credit rating advice from its advisers, on a daily basis as and when ratings change, and counterparties are checked promptly.

6.7 Country and Sector considerations

Due care will be taken to consider the country, group and sector exposure of the Council's investments.

- no more than 25% of the total invested will be placed with any one non-UK country at any time;
- limits in place above will apply to any one individual group of companies;
- Banking, Building Society and other sector limits will be monitored regularly for appropriateness.

6.8 Use of additional information other than credit ratings

The Code of Practice requires the Council to supplement credit rating information. Market information (for example Credit Default Swaps, equity prices, negative rating watches/outlooks) will be applied to compare the relative security of investment counterparties.

6.9 Economic Investment Considerations

Expectations for 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 early 2015.

6.10 Operating Restrictions

The criteria for choosing counterparties set out above provide a sound approach to investment in "normal" market conditions. Members are asked to approve the criteria above but under the current market conditions the Executive Director, supported by the informal Treasury Monitoring Panel, may temporarily restrict investment activity further to specific counterparties or by amount and period.

7. SENSITIVITY TO INTEREST RATE MOVEMENTS

Future Council accounts will be required to disclose the impact of risks on the Council's treasury management activity. Whilst most of the risks facing the treasury management service are addressed elsewhere in this report (credit risk, liquidity risk, market risk, maturity profile risk), the impact of interest rate risk is not quantified. The table below highlights the estimated impact of a 0.5% increase/decrease in all interest rates to treasury management costs/income for 2013/14.

Revenue Budgets	2013/14 Estimated @ 0.5% £000	2013/14 Estimated @ 1% (0.5% + 0.5%) £000	2013/14 Estimated @ 0% (0.5% - 0.5%) £000
Interest on Long-Term Borrowing	-4,460	-4,460	-4,460
Interest on Internal Borrowing	21	42	0
Investment income	300	600	0

It should be noted that current long term borrowing has fixed rates of interest and therefore, should interest rates fall or rise, the actual interest payable will remain unchanged. No new long term borrowing is anticipated for 2013/14.

8. TREASURY MANAGEMENT LIMITS ON ACTIVITY

8.1 Treasury Management Prudential Indicators and Limits on Activity.

There are further treasury prudential indicators. The purpose of these prudential indicators is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if the limits are set at a level that is too restrictive they could limit opportunities to reduce costs.

The table below at 8.2 shows that up to 100% of fixed rate borrowing can be raised in periods of 10 years or more. A 25% limit has been set for shorter periods

8.2 The indicators for borrowing are shown in the following table:

Borrowing	**2013/14 Upper**		**2014/15 Upper**		**2015/16 Upper**	
Estimated Maximum Principal sums borrowed	£172.7m		£172.7m		£172.7m	
Limits - fixed interest rates	100%		100%		100%	
Limits - variable interest rates	50%		50%		50%	
Maturity Structure of fixed interest rate borrowing						
	Lower	**Upper**	**Lower**	**Upper**	**Lower**	**Upper**
Under 12 months	0%	25%	0%	25%	0%	25%
12 months to 2 years	0%	25%	0%	25%	0%	25%
2 years to 5 years	0%	25%	0%	25%	0%	25%
5 years to 10 years	0%	25%	0%	25%	0%	25%
10 years and above	0%	100%	0%	100%	0%	100%

8.3 The indicators for investment are shown in the following table:

Investments	**2013/14 Upper**		**2014/15 Upper**		**2015/16 Upper**	
Estimated Maximum sums invested	£55m		£53m		£52m	
Estimated Maximum sums invested for more than 1 year	£0m		£0m		£0m	
Limits - fixed interest rates	100%		100%		100%	
Limits - variable interest rates	100%		100%		100%	
Maturity Structure of investments						
	Lower	**Upper**	**Lower**	**Upper**	**Lower**	**Upper**
Under 12 months	100%	100%	100%	100%	100%	100%

9. PERFORMANCE INDICATORS

The Code of Practice for 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. An example of performance indicators often used for the treasury function is:

- Investments – returns should be above the average 7 day LIBID rate

The result of this indicator will be reported in the Annual Treasury Report at each year-end.

10. TREASURY MANAGEMENT CONSULTANTS

The Council uses Sector Treasury Services as its external treasury management advisors. Sector provides a range of services which include:

- Technical support on treasury matters and capital finance issues;
- Economic and interest rate analysis;
- Generic investment advice on interest rates, timing and investment instruments;
- Credit ratings/market information service comprising the three main credit rating agencies;

Whilst the consultants provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice, the Council recognises that responsibility for treasury management decisions remains with the Council at all times. The Council ensures that the terms of the appointment is properly documented and its value is assessed and documented and is subject to regular review.

11. USE OF MONEY BROKERS

The Council will use money brokers to place investments with counterparties when possible. The broker has access to the money markets and will be able to determine the best rate of investment for the Council given the counterparties that the Council can invest with and the type of investment required.

The Council will also deal directly with highly rated organisations which may not use money brokers.

12. MEMBER AND OFFICER TRAINING

The increased Member consideration of treasury management matters and the need to ensure officers dealing with treasury management are trained and kept up to date requires a suitable training process for Members and officers.

This Council has addressed this important issue by conducting regular treasury panel meetings with the portfolio holder for Finance & Efficiency and members of the Audit Committee. The Council's treasury consultants have also attended a treasury panel meeting and have given a presentation at a meeting of the Audit Committee which oversees the treasury function.

Further training can be arranged on this subject during the year if required.

13. LOCAL ISSUES

Paragraph 6.10 explains that the Executive Director can restrict investment parameters because of current economic conditions if necessary.
Regular treasury meetings will be held during the year between the Executive Director, the informal Treasury Monitoring Panel and the Treasury Manager to consider the prevailing economic and investment situation.

Annex B1

TREASURY MANAGEMENT PRACTICE (TMP)1 – Credit and Counterparty Risk Management

1. 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.

2. The key intention of the investment guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield.

3. In order to meet this objective the guidance requires this Council to have regard to the CLG's guidance on Local Government Investments and the 2011 revised CIPFA Treasury Managements in Public Services Code of Practice and Cross Sectoral Guidance Notes and includes the Statement of Treasury Management Practices.

4. This Council adopted the Code on 25 February 2002 and will apply its principles to all investment activity. In accordance with the Prudential Code, this part of the approved treasury management practices must be agreed prior to each financial year and amended if necessary.

5. Annual Investment Strategy

5.1 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 year, covering the identification and approval of the following:

- The strategy guidelines for decision making on investment decisions.
- Specified investments that the Council will use. - These are highly credit rated and highly liquid investments in sterling and with a maturity of no more than a year.
- Non-specified investments that the Council will use. -This identifies the greater risk implications of investments that are not so highly credit rated or are for a longer duration. It specifies the limits for which investments may be made with each counterparty at any time.

5.2 The investment strategy proposed for the Council is as set out in paragraph 6 of Annex B:

Annex B2

SECURITY, LIQUIDITY AND YIELD BENCHMARKING

1. Benchmarking and Monitoring Security, Liquidity and Yield in the Investment Service

Members should consider and approve 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.

1.1 Yield

These benchmarks are currently widely used to assess investment performance. Local measures of yield benchmarks are shown at paragraph 6.2.3 in the Treasury Management Strategy at Annex B:

Security and liquidity benchmarks are already intrinsic to the approved treasury strategy through the counterparty selection criteria and some of the prudential indicators. Proposed benchmarks for the cash type investments are shown in the main body of Annex B and these will form the basis of future reporting in this area.

1.2 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 objectives” (CIPFA Treasury Management Code of Practice).

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 shown at paragraph 6.2.2 in the Treasury Management Strategy at Annex B

1.3 Security of the investments

In the 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 below shows average defaults for differing periods of investment grade products for each Fitch long term rating category over the period 1990 to 2011.

Long term rating	*1 year*	*2 years*	*3 years*	*4 years*	*5 years*
AAA	*0.00%*	*0.02%*	*0.06%*	*0.09%*	*0.13%*
AA	*0.02%*	*0.04%*	*0.14%*	*0.28%*	*0.36%*
A	*0.09%*	*0.25%*	*0.43%*	*0.60%*	*0.79%*
BBB	*0.23%*	*0.65%*	*1.13%*	*1.70%*	*2.22%*

Should the Council be investing for longer than a year and have a minimum long term rating criteria of “A”, the average expectation of default would be 0.09% of the total investment (e.g. for a £1m investment the average loss would be £900).

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.

Although the Council is investing for periods of up to 1 year only, the long term interest ratings and default rates are an additional tool to use when determining security risk.

The Council’s maximum security risk benchmark for the whole portfolio, when compared to these historic default tables, is shown at paragraph 6.2.1 in the Treasury Management Strategy at Annex B.

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.

New Forest District Council's Investment Criteria

Current Strategy

Counterparty Criteria	Investment Restrictions as Agreed Strategy by Council	Current Operational Restrictions
UK Gilts and the DMO	Limit will be £10m per instrument	**Limit of £10m per instrument**
Public Bodies; LAs	20% of total - limit £10m per org for 5yrs.	**Limit of £10m Per org. for 1 year**
Supranational Bonds	20% of total – limit £5m per org.	Not to be Used
UK Banks – Other than Barclays; Lloyds; HSBC; RBS Grp	ST rating of F-1. 20% of total but limit of £5m	Not to be Used
UK Banks – Barclays; Lloyds; HSBC, RBS Grp	Limit of £10m For up to 5 years	**£10m Lloyds & RBS Group for 1 yr only Others - 3 months only**
Non-UK Banks	Criteria as UK Banks - Sovereign rating AAA;	Not to be Used
Building Societies – Other than Nationwide	ST rating of F-1. 20% of total but limit of £5m	Not to be Used
Building Society - Nationwide	Limit of £10m For up to 5 years	**Limit of £10m For 3 months only**
Building Societies ST rating of F1	20% of total; Limit £3m for 6 months	Not to be Used
Church, Charity and CCLA	20% of total; Limit £2m for 3 months	Not to be Used
Unrated Building Societies - assets greater than £250m	20% of total; Limit £3m For up to 3 months	Not to be Used
Wholly owned by UK Govt	20% of for 6 months	Not to be Used
MMFs	Credit rated (AAA); Investment Limit of £10m per MMF fund	**(AAA) Limit of £10m per MMF fund**

Proposed Strategy 2013/14

Counter-party Criteria	Minimum Credit Criteria	Sover-eign Rating	Approx. maximum % core investment	Approx. maximum % Temporary investment	Approx. Limit per Counter-party
DMO	N/A	UK	100%	100%	N/A
UK Local Authorities	N/A	UK	100%	100%	£6m
Money Market Funds	AAA	N/a	100%	100%	£10m
UK Gov. part owned UK Banks	N/A	UK	30%	30%	£6m
Other UK High Street Banks & Building Societies	Short-Term F1	UK	30%	30%	£6m
Other Highly rated Banks	Short-term F1+	AAA	30%	30%	£6m
Other Highly rated Banks	Short-term F1	AAA	15%	15%	£6m
Other Highly rated Banks	Short-term F1+	AA	15%	15%	£6m