CABINET 1 FEBRUARY 2012

TREASURY MANAGEMENT STRATEGY REPORT 2012/13

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 2012/13 – 2014/15 and sets out the expected treasury operations for this period. It fulfils four key legislative requirements.

2. MAJOR CHANGES

The Council currently pays into the HRA housing subsidy system which is being discontinued from 1 April 2012. The Council needs to borrow up to £143.4m on the 28 March 2012 and pay this to the Department of Communities and Local Government (DCLG) to comply with the settlement requirements.

The Executive Director (Section 151 officer) will make the final decisions on the amount to be borrowed and the maturity profile of debt most beneficial to the Council, in consultation with the Finance and Efficiency Portfolio Holder.

3. POLICIES AND APPROVALS REQUIRED

3.1 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.

3.2 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.

3.3 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 2012/13 to 2014/15. 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 2012/13 must be agreed prior to 1 April 2012. 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.

3.4 Investment Strategy

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

This strategy is in accordance with the CLG Investment Guidance and is also 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 2012/13 to 2114/15.

4. RECOMMENDATIONS

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

4.1 The Prudential Indicators and Limits for 2012/13 to 2014/15 contained within Annex A of the report, including the Authorised Limit prudential indicator.

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

4.3 The Treasury Management Strategy 2012/13 to 2014/15, and the treasury Prudential Indicators contained within Annex B.

4.4 The Investment Strategy 2012/13 contained in the Treasury Management Strategy (Annex B), and the detailed criteria included in Annex B1.

4.5 That the Executive Director may, in consultation with the Finance and Efficiency Portfolio Holder and delegated powers, make the final decisions on the amount to be borrowed in respect of the HRA settlement and the maturity profile of the debt which is most beneficial to the Council.

Further Information
Please contact Jan Hawker, Treasury Management Accountant Ext. 5722
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Background Papers
The Prudential Code, CIPFA Guidance Notes and CLG Investment Guidance.
General Fund Revenue Budget and Capital Programme 2012/13(on this agenda)

g/word/treasury performance reports/treasury management strategy report 201213

ANNEX A

THE CAPITAL PRUDENTIAL INDICATORS 2011/12 – 2013/14

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 A key issue facing the Council is the impact of planned HRA reform. This will essentially end the housing subsidy system and will see the HRA as a standalone business. The Council needs to approve revised limits to reflect the impact of this reform.

1.6 The Council currently pays into the HRA housing subsidy system, and in order to stop future payments from 1 April 2012 the Council is required to pay the Department of Communities and Local Government (DCLG) £143.4 million. This payment is effectively HRA debt, and so the prudential indicators have been adjusted to reflect this change. The actual payment will be made on 28 March 2012 and so the indicators will take immediate effect from the approval of these limits by Council.

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	**2011/12 Revised £000**	**2012/13 Estimate £000**	**2013/14 Estimate £000**	**2014/15 Estimate £000**
	19,190	14,357	11,916	10,117
Financed by:				
Capital receipts	530	1,105	1,075	430
Capital grants	3,519	2,468	3,987	2,290
Capital reserves	3,486	215	-1,129	-317
Developers Contributions	726	760	0	0
Revenue	8,957	7,741	5,935	6,299
Net capital financing requirement (CFR)	**1,972**	**2,068**	**2,048**	**1,415**

3. CAPITAL FINANCING REQUIREMENT

3.1 Capital expenditure will impact directly on the overall CFR if a borrowing requirement arises as shown at 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 HRA housing reform settlement also now forms part of the CFR.

3.3 The Capital Financing Requirement is reduced by the amount of any provision that is made to repay loan in the future. This 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)	**2011/12 Revised £000**	**2012/13 Estimate £000**	**2013/14 Estimate £000**	**2014/15 Estimate £000**
CFR–Non Housing	5,150	5,313	5,439	4,950
CFR - Housing	1,897	1,897	1,897	1,897
HRA Settlement	143,400	143,400	143,400	143,400
Total CFR at year end	150,447	150,610	150,736	150,247
Movement in CFR from one year to the next		**163**	**126**	**-489**
For each year the movement in CFR is represented by				
Net Financing Need (The amount of capital expenditure financed by loan)	1,972	2,068	2,048	1,415
HRA Settlement	143,400	0	0	0
MRP movement (the amount by which any loan requirement is reduced)	-1,889	-1,905	-1,922	-1,904
Movement in CFR	**143,483**	**163**	**126**	**-489**

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 will set a Housing Business Plan that charges amounts to revenue to ensure that any borrowings are reduced over the course of the Plan. A policy of revenue provision will be approved as part of the final Business Plan setting process.

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.

Estimated Year End Resources	2011/12 Revised £m	2012/13 Estimate £m	2013/14 Estimate £m	2014/15 Estimate £m
Fund Balances	13.8	13.4	15.1	17.3
Capital Receipts	2.4	2.4	1.9	1.9
Earmarked Reserves	5.0	4.8	5.9	6.3
Total Core Funds	**21.2**	**20.6**	**22.9**	**25.5**
Temporary Cash Flow	6.2	5.1	3.4	2.6
Under (-) /Over Borrowing (CFR)	-7.0	-7.2	-7.3	-6.8
Investments at 31 March	**20.4**	**18.5**	**19.0**	**21.3**

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 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:	**2012/13**		
General Fund Financing cost	£400,000	=	2.0%
General Fund Net Revenue Stream	£19,595,000		

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

	2011/12 Revised	**2012/13 Estimate**	**2013/14 Estimate**	**2014/15 Estimate**
Non - HRA	0.6%	2.1%	1.9%	1.8%
HRA (inclusive of settlement)	0.4%	17.5%	0.0%	0.0%

The significant increase in financing costs for the HRA in 2012/13 is entirely due to the borrowing in respect of the HRA settlement. However this will be met from the rents that are retained under the settlement arrangements as they will no longer be paid over to DCLG as they were under the previous subsidy calculations.

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 how the changes to the capital programme will affect the Band D Council Tax.

6.2.2 This 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 2012/13	**Forward Projection 2013/14**	**Forward Projection 2014/15**
Change to Council Tax-Band D	4.10%	-2.94%	0.27%
Change to Council Tax cost year on year	£6.38	-£4.76	£0.43

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 2012/13	**Forward Projection 2013/14**	**Forward Projection 2014/15**
Change to the Weekly Housing Rent levels	£7.61	-£5.42	£1.40

ANNEX B

TREASURY MANAGEMENT STRATEGY 2011/12 – 2013/14

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 (25 February 2010). This adoption is the requirement of one of the prudential indicators.

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. A mid-year monitoring report and a year-end report on actual activity for the year are also required.

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 debt and investment position are shown below:

	2011/12 Revised £m	**2012/13 Estimated £m**	**2013/14 Estimated £m**	**2014/15 Estimated £m**
External Debt				
Debt at 1 April	0.0	143.4	143.4	143.4
Expected change in debt	0.0	0.0	0.0	0.0
HRA Settlement	143.4	0.0	0.0	0.0
Debt at 31 March	**143.4**	**143.4**	**143.4**	**143.4**
Investments				
Total Investments at 31 March	**-20.4**	**-18.5**	**-19.0**	**-21.2**
Investment change		1.9	-0.5	-2.3

The reduction in the investment balance between 2011/12 and 2012/13 of £1.8 million reflects the use of loan, capital receipts, developers' contributions, and capital reserves to finance capital purchases in 2012/13 (£4.0 million of investments), offset by the anticipated receipt of new sums of developers' contributions and capital receipts and new cash flow balances (£2.2 million).

3 LIMITS TO BORROWING ACTIVITY

3.1 Net external borrowing

The Council needs to make sure that net external borrowing in 2012/13 does not exceed the total of the CFR at the end of 2012/13 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.

Net External Borrowing	**2011/12 Estimate £m**	**2012/13 Estimate £m**	**2013/14 Estimate £m**	**2014/15 Estimate £m**
Gross Borrowing	143.4	143.4	143.4	143.4
Investments	-20.4	-18.5	-19.0	-21.3
Net Borrowing	**123.0**	**124.9**	**124.4**	**122.1**
CFR at year end	150.4	150.6	150.7	150.2
Safety Margin for Limit of Capital Expenditure to be Financed from Loan	**27.4**	**25.7**	**26.3**	**28.1**

As net borrowing of £124.9 million in 2012/13 does not exceed the CFR in any year up to 2014/15 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. This is lower than the CFR shown at 3.1 above because no external debt has been raised to fund borrowing in previous years. Internal reserves have been used rather than raising external loans. It is anticipated that the only debt that will be raised, other than short-term temporary debt to cover cash flow requirements, will be the HRA settlement debt.

Operational limit for external debt	**2011/12 Revised £m**	**2012/13 Estimate £m**	**2013/14 Estimate £m**	**2014/15 Estimate £m**
Borrowing	0.0	0.0	0.0	0.0
HRA settlement	143.4	143.4	143.4	143.4
Total Borrowing	143.4	143.4	143.4	143.4

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	2011/12 Revised £m	2012/13 Estimate £m	2013/14 Estimate £m	2014/15 Estimate £m
Borrowing	30.0	30.0	30.0	30.0
HRA settlement	143.4	143.4	143.4	143.4
Total Borrowing	173.4	173.4	173.4	173.4

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 £143.4m plus the Housing Subsidy Notional Debt amount of £12.8m

HRA Debt Limit	2011/12 Revised £m	2012/13 Estimate £m	2013/14 Estimate £m	2014/15 Estimate £m
Total	157.0	157.0	157.0	157.0

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.

Year	Base Rate	Money Market Rate		PWLB Borrowing Rate		
	%	3 Month %	1 Year %	5 year %	25-year %	50-year %
2011/12	0.5	0.7	1.5	2.3	4.2	4.3
2012/13	0.5	0.7	1.6	2.4	4.3	4.4
2013/14	0.8	1.0	2.0	2.7	4.6	4.7
2014/15	1.9	2.0	2.9	3.3	5.0	5.1

4.2 Bank Base 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. 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. The Comprehensive Spending Review, which seeks to reduce the UK's annual fiscal deficit, will also depress growth during the next few years.

4.3 Fixed interest borrowing rates are based on UK gilt yields. 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 high levels of volatility as the Eurozone debt crisis has evolved.

4.4 The Public Works Loan Board (PWLB) is offering Councils a special reduced rate for any borrowing undertaken on 28 March 2012 for the HRA settlement. The Executive Director will borrow the necessary funds in accordance with the agreed strategy for this particular exercise.

5. BORROWING AND DEBT STRATEGY 2012/13 – 2014/15

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 be adopted with the 2012/13 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 requirement for the HRA reform settlement to be made to the DCLG on 28 March 2012 will require a separate consideration of a borrowing strategy. The Council will need to have the cash settlement amount of £143.4m available by the 28th March 2012, so separate borrowing solely for this purpose is anticipated. The PWLB are providing loans at interest rates 0.85% lower than the usual PWLB interest rates solely for the settlement requirements. This provides a compelling reason to utilise this borrowing availability. The exact structure of debt to be drawn is currently being considered by officers to ensure that it meets the requirements of the HRA business plan and the overall requirements of the Council. Any decisions will be reported to the appropriate decision making body at the next available opportunity.

5.4 The Executive Director, 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 above and Members wishes. 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 mid-year or annual report.

6. INVESTMENT STRATEGY 2012/13 – 2014/15

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 events have heightened the consciousness of this risk. As a result of these concerns officers are implementing an operational investment strategy which tightens the controls already in place in the approved investment strategy.

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 Report.

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 **0.06%.**

The Council can invest in building societies that are not credit rated. By default the credit rating applied to them for this benchmarking purpose is BBB+. This is a cautious approach as historically there has been no default of any UK building society. The historic security risk for these organisations is therefore considered small.

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

	1 year	***2 years***	***3 years***	***4 years***	***5 years***
Maximum	*0.06%*	*0%*	*0%*	*0%*	*0%*

There is no risk for any period of longer than one year currently as the Council is investing in periods of less than one year because of the economic climate.

6.2.2 Liquidity

In respect of this area the Council seeks to maintain:

- Bank overdraft - £0.75m
- Liquid short term deposits of at least £0.25m available with instant access.
- Weighted Average Life benchmark is expected to be 0.5 years, with a maximum of 2 years.

In 2011/12 to date the weighted average life benchmark for investment periods is 113 days. It is likely that this benchmark will increase as decisions are made to invest for longer periods as the global economic situation eases.

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

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

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

The Council uses all three credit rating agencies, Moody's, Standard & Poors and Fitch, to determine which counterparties to use.

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.

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 dealing.

6.4.1 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.

Both specified and non-specified investments are approved under the new guidance and will form part of a council's policy.

6.4.2 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:

Counterparty Criteria	Investment Restrictions
UK Government - gilts and the Debt Management Office (DMO).	The Counterparty limit for the DMO will be £10m
Public Bodies; Local Authorities, Parish Councils, Other Public Sector, etc	20% of total but maximum of £10m per organisation.
Supranational Bonds	20% of total but maximum £5m per issuer.
UK Banks – Other than Barclays; Nat West; Lloyds TSB; HSBC; RBS	which have at least one of the short – term credit ratings in the table below; 20% of total but a maximum of £5m
Non-UK Banks	domiciled in a country with a minimum Sovereign long term rating of AAA; and which have at least the short – term credit ratings in the table below; 20% of total but a maximum of £5m
Building Societies - Other than Nationwide; which have at least one of the following short– term credit ratings.	which have at least one of the short – term credit ratings in the table below; 20% of total but a maximum of £5m
Money Market Funds (MMFs)	highly credit rated (AAA); Maximum investment of £10m per MMF

Credit Rating Agency	Short – Term Credit Rating
Fitch	F - 1
Moody's	P - 1
Standard & Poors	A - 1

6.4.3 Non-Specified Investments

Non – Specified investments are any other type of permissible investment not defined as specified above and include:

- UK Government Gilts with a maturity of greater than 1 year.
- Local Authorities, Parish Council, Other Public Sector, etc. with a maturity of greater than 1 year.
- Supranational bonds – with a maturity date beyond 1 year.
- Institutions not meeting the credit rating at 6.4.2 above or where other restrictions have been applied as follows:

Counterparty Criteria	Investment Restrictions
UK Banks - Barclays; Nat West; Lloyds TSB; HSBC, RBS	Counterparty limit of £10m for maximum of 5 years
Building Society - Nationwide	Counterparty limit of £10m for maximum of 5 years
Building Societies with a short-term credit rating of at least F-2; P-2; A-2 which are Eligible Institutions (See Annex B1)	20% of total but maximum of £3m for up to 6 months
Unrated Building Societies with total assets greater than £250 million which are Eligible Institutions (See Annex B1)	20% of total but maximum of £2m for up to 3 months
Public Bodies; Local Authorities, Parish Councils, Other Public Sector, etc	Counterparty limit of £10m for maximum of 5 years
Church, Charity and Local Authority (CCLA)	20% of total but maximum of £2m for up to 3 months
Organisations wholly owned by UK Government	20% of total but maximum of £10m for up to 6 months

- Other Banks and Building Societies – with a high credit rating but with a maturity of more than 1 year and have, as a minimum, the following Fitch, Moody's and Standard and Poors equivalent credit ratings as follows:

Long-Term Credit Rating	Short term	Support	Maximum Period of Investment
A (+/-)	F - 1	3	Up to 2 years
AA (+/-)	F - 1	1	Up to 4 years
AAA (+/-)	F - 1	1	Up to 5 years

All investments will retain the general rule that the maximum that can be invested with any one counterparty at any one time is 20% of the total investment but with the exception that if the investment is with Barclays Bank, Lloyds TSB Bank, HSBC Bank, RBS, Nationwide Building society or a public body it may be 100% of core funds subject to the £10m counterparty limit.

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. If this happens balances held on account will be kept to a minimum working amount.

6.4.5 More information about these categories of investment is shown at Annex B1 paragraph 5.3.

6.5 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.

6.6 Other Criteria

6.6.1 Any longer-term investments will need to fit in with the principles of the treasury prudential indicator for total sums invested for periods longer than 364 days as shown at 8.3 below.

6.6.2 When applying the 20% rule as shown in the tables 6.4.2 and 6.4.3 above, should the total sum invested be less than £2.5m, then the maximum investment may be £500,000.

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

Additional requirements under the Code of Practice now require 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 late 2013.

6.10 Temporary 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 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 1% increase/decrease in all interest rates to treasury management costs/income for 2012/13.

Revenue Budgets	2012/13 Estimated @ 1.5% £000	2012/13 Estimated + 1% £000	2012/13 Estimated -1% £000
Interest on Long-Term Borrowing	-3,972	-6,620	-1,324
Interest on Internal Borrowing	10	17	3
Investment income	525	875	175

However, it should be noted that it is likely that any long term borrowing will have fixed interest rates and therefore, should interest rates fall or rise, the actual interest payable will remain unchanged.

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 are too restrictive they will actually limit opportunities to reduce costs.

The table below at 8.2 shows that up to 100% of fixed rates can be raised in any period. This is because the Council is borrowing up to £143.4m of loans under the HRA Finance Review. A decision has not been made on the number of loans and their maturity profile at the time of writing this report. Therefore this strategy allows maximum flexibility.

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

Borrowing	2012/13 Upper		2013/14 Upper		2014/15 Upper	
Estimated Maximum Principal sums borrowed	£174.0m		£174.0m		£174.0m	
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%	100%	0%	100%	0%	100%
12 months to 2 years	0%	100%	0%	100%	0%	100%
2 years to 5 years	0%	100%	0%	100%	0%	100%
5 years to 10 years	0%	100%	0%	100%	0%	100%
10 years and above	0%	100%	0%	100%	0%	100%

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

Investments	2012/13 Upper		2013/14 Upper		2014/15 Upper	
Estimated Maximum sums invested	£62.4m		£63.0m		£65.3m	
Estimated Maximum sums invested for more than 364 days	£15m		£15m		£15m	
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	25%	100%	25%	100%	25%	100%
12 months to 2 years	0%	75%	0%	75%	0%	75%
2 years to 5 years	0%	75%	0%	75%	0%	75%

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 ADVISERS

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

11. USE OF MONEY BROKERS

Generally the Council will use money brokers to place investments with counterparties. 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 type of investment required.

However, several UK highly rated organisations now conduct their own treasury transactions and no longer use money brokers. When beneficial to the Council, investments may be made by dealing directly with these counterparties.

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.

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.

At the time of writing this report the parameters are restricted because of the uncertainty about counterparty creditworthiness.

Regular treasury meetings are held between the Executive Director, the portfolio holder for Finance & Efficiency 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 CIPFA publication Treasury Management in the 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:

5.3 Further information about some investment categories are as follows:-

i) Supranational Bonds

(a) Multilateral development bank bonds - These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Investment Bank etc.).

(b) A financial institution that is guaranteed by the United Kingdom Government (e.g. The Guaranteed Export Finance Company {GEFCO}) - The security of interest and principal on maturity is on a par with the Government and so very secure, and these bonds usually provide returns above equivalent gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.

ii) **Gilt edged securities** with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.

iii) **Building societies** The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The Council may use such building societies which are Eligible Institutions. An Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008. These institutions have been subject to suitability checks before inclusion, and have access to HM Treasury liquidity if needed.

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 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 2009.

Long term rating	***1 year***	***2 years***	***3 years***	***4 years***	***5 years***
AAA	*0.00%*	*0.02%*	*0.05%*	*0.10%*	*0.16%*
AA	*0.03%*	*0.06%*	*0.12%*	*0.17%*	*0.25%*
A	*0.08%*	*0.22%*	*0.40%*	*0.56%*	*0.74%*
BBB	*0.23%*	*0.69%*	*1.20%*	*1.77%*	*2.37%*

The Council's minimum long term rating criteria is currently "A", meaning the average expectation of default for a one year investment in a counterparty with a "A" long term rating would be 0.08% of the total investment (e.g. for a £1m investment the average loss would be £800).

This is only an average - any specific counterparty loss is likely to be higher - but these figures do act as a proxy benchmark for risk across the portfolio.

The Council's maximum security risk benchmark for the whole portfolio, when compared to these historic default tables, is 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. As this data is collated, trends and analysis will be collected and reported. Where a counterparty is not credit rated a proxy rating will be applied.