COUNCIL
1 MARCH 2012

ITEM NO. 4 (d)

PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT STRATEGY REPORT 2012/13

SUMMARY REPORT

Purpose of the Report

1. This report requests Council to adopt the following :-

   (a) The Prudential Indicators and Limits for 2012/13 to 2014/15 relating to capital expenditure and Treasury Management activity;

   (b) A policy statement relating to the Minimum Revenue Provision;

   (c) The Treasury Management Strategy 2012/13, which includes the Investment Strategy for 2012/13.

Summary

2. The report outlines the Council's prudential indicators for 2012/13 – 2014/15 and sets out the expected treasury operations for this period. It fulfils key legislative and guidance requirements:

   (a) The reporting of the **prudential indicators** setting out the expected capital activities treasury management prudential indicators are now included as treasury indicators in the CIPFA Treasury Management Code of Practice;

   (b) The Council's **Minimum Revenue Provision (MRP) Policy**, which sets out how the Council will pay for capital assets through revenue each year;

   (c) The **treasury management strategy** statement which sets out how the Council's treasury service will support capital decisions taken above, the day to day treasury management and the limitations on activity through treasury prudential indicators;

   (d) The key indicator is the **authorised limit**, the maximum amount of debt the could afford in the short term, but which is not sustainable in the longer term;

(e) The **investment strategy** which sets out the Council's criteria for choosing the investment counterparties and limiting exposures to the risk of loss.

3. The information contained in the report regarding the councils expenditure plans, Treasury Management and Prudential Borrowing activities indicate that they are:-

   (a) Within the statutory framework and consistent with the relevant codes of practice.

   (b) Prudent, affordable and sustainable.

   (c) An integral part of the Council's Revenue and Capital Medium Term Financial Plans

4. This report was considered by Audit Committee at its special meeting on 24th January 2012 under their responsibilities for ensuring effective scrutiny of the treasury management and policies. Audit Committee resolved that it was satisfied with the Prudential Indicators and Treasury Management Strategy, as presented in this report and that the report be forwarded to Cabinet for its onward referral to Council for its consideration.

Recommendation

5. It is recommended that the Audit Committee examine the following and pass on any comments to the Council via Cabinet in order that they approve them:-

   (a) The Prudential Indicators and limits for 2012/13 to 2013/14 summarised in Tables 1 and 2

   (b) The Minimum Revenue Provision (MRP) statement contained within paragraph 28

   (c) The Treasury Management Strategy 2012/13 to 2014/15 as summarised in paragraphs 38 to 56.

   (d) The Annual Investment Strategy 2012/13 contained in paragraphs 57 to 87

Reasons

6. The recommendations are supported by the following reasons :-

(a) In order to comply with the Prudential Code for Capital Finance in Local Authorities and the Department for Communities and Local Government (CLG) guidance on investments;

(b) To comply with the requirements of the Local Government Act 2003:

(c) To approve a framework for officers to work within when making investment decisions.

Paul Wildsmith
Director of Resources

Background Papers

Annual Statement of Account 2010/11
Draft Capital MTFP 2012/13 to 2014/15

Elaine Hufford : Extension 2447

S17 Crime and Disorder	This report has no implications for S 17 Crime and Disorder.
Health and Well Being	This report has no implications for the Councils Health and Well being agenda.
Carbon Impact	This report has no implications for the Councils Carbon Emissions.
Diversity	This report has no implications for the Councils Diversity agenda.
Wards Affected	All wards.
Groups Affected	All groups.
Budget and Policy Framework	This report must be considered by Council.
Key Decision	This is not an executive decision.
Urgent Decision	For the purposes of call in this report is not an urgent decision.
One Darlington: Perfectly Placed	This report has no particular implications for the sustainable Community Strategy.
Efficiency	The report refers to actions taken to reduce costs and manage risks.

MAIN REPORT

Information and Analysis

Background

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

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

9. CIPFA defines treasury management as:

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

Reporting requirements

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

Prudential and Treasury Indicators and Treasury Strategy (This report)

11. The first, and most important report covers:

    (a) the capital plans (including prudential indicators);

    (b) a Minimum Revenue Provision Policy (how residual capital expenditure is charged to revenue over time);

    (c) the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and

(d) an investment strategy (the parameters on how investments are to be managed).

A Mid Year Treasury Management Report

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

An Annual Treasury Report

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

Treasury Management Strategy for 2012/13

14. The strategy for 2012/13 covers two main areas:

(a) Capital Issues

i. the capital plans and the prudential indicators;
ii. the MRP strategy.

(b) Treasury management Issues

i. the current treasury position;
ii. treasury indicators which will limit the treasury risk and activities of the Council;
iii. prospects for interest rates;
iv. the borrowing strategy;
v. policy on borrowing in advance of need;
vi. debt rescheduling;
vii. the investment strategy;
viii. creditworthiness policy; and
ix. policy on use of external service providers.

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

16. A summary of the key prudential indicators and limits are contained inTables 1 and 2

Table 1 – Capital Expenditure and Borrowing

	2011/12 Revised	**2012/13 Estimated**	**2013/14 Estimated**	**2014/15 Estimated**
Capital Expenditure	£72.195m	£17.997m	£12.447m	£13.453m
Capital financing requirement	£177.308m	£172.375m	£167.919m	£163.515m
Ratio of financing costs to net revenue stream – General Fund See paragraph 31	4.13%	7.61%	7.45%	7.13%
Ratio of financing costs to net revenue stream – HRA See paragraph 32	8.42%	23.28%	22.46%	21.86%
Incremental impact of **new** capital investment decisions on the band D Council Tax	Nil	£0.57	£3.16	£5.74
Incremental impact of **new** capital investment decisions on Housing Rents levels	Nil	Nil	Nil	Nil
Operational boundary for external debt	£136.698m	£134.900m	£133.700m	£132.400m
Authorised limit for external debt	£150.368m	£148.390m	£147.070m	£145.640m

Table 2 – Treasury Management

	2012/13 Upper Limit	2013/14 Upper Limit	2014/15 Upper Limit
Limits on fixed interest rates	100%	100%	100%
Limits on variable interest rates	40%	40%	40%
Maximum principal sums invested > 364 days	£10m	£10m	£10m

Maturity Structure of fixed interest rate borrowing 2012/13		
	Lower Limit	**Upper Limit**
Under 12 months	0%	25%
12 months to 2 years	0%	40%
2 years to 5 years	0%	60%
5 years to 10 years	0%	80%
10 years and above	0%	100%

The Capital Prudential Indicators 2012/13 – 2014/15

17. The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members overview and acknowledge capital expenditure plans.

18. A key issue facing the Council is the impact of planned HRA reform. This would essentially end the impact of the housing subsidy system and will see the HRA as a stand alone business. The legislation has yet to be enacted, but the Council will need to approve revised limits in expectation of the reform going ahead.

19. 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 CLG £33.800M. 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 the 28 March 2012 and so the indicators will take immediate effect from the approval of these limits by Council. The change is expected to be beneficial to the Council by freeing the HRA from contributions to Central Government

thereby keeping all income from rents received to be reinvested into the housing stock.

Capital Expenditure

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

Table 3 Capital Expenditure

	2011/12 Estimate £m	**2012/13 Estimate £m**	**2013/14 Estimate £m**	**2014/15 Estimate £m**
General Fund	**22.956**	**12.307**	**7.129**	**7.029**
HRA existing	15.439	5.690	5.318	6.424
HRA settlement	33.800			
HRA	**49.239**	**5.690**	**5.318**	**6.424**
Total	**72.195**	**17.997**	**12.447**	**13.453**

21. The financing need below excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.

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

Table 4 Financing of the Capital Programme

	2011/12 Estimate £m	**2012/13 Estimate £m**	**2013/14 Estimate £m**	**2014/15 Estimate £m**
General Fund	22.956	12.307	7.129	7.029
HRA	15.439	5.690	5.318	6.424
HRA settlement	33.800			
Total	**72.195**	**17.997**	**12.447**	**13.453**
Financed by:				
Capital receipts	1.303	-	-	-
Capital grants	23.080	15.607	10.929	10.829
Capital Contributions	0.558	0.500	-	-
Revenue	5.410	0.890	0.518	1.624
Net financing need for	**41.844**	**1.000**	**1.000**	**1.000**

the year Borrowing				

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

23. The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

24. Following accounting changes the CFR includes any other long term liabilities (e.g. PFI schemes, finance leases) brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of schemes include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £21.898M of such schemes within the CFR.

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

Table 5 – CFR Projections

	2011/12 Estimate £m	**2012/13 Estimate £m**	**2013/14 Estimate £m**	**2014/15 Estimate £m**
CFR – General Fund	79.932	78.000	75.397	72.818
CFR – PFI and Finance leases	21.898	20.096	18.805	17.542
CFR - housing	41.678	40.479	39.917	39.355
HRA Settlement	33.800	33.800	33.800	33.800
Total CFR	**177.308**	**172.375**	**167.919**	**163.515**
Movement in CFR	**35.796**	**-4.933**	**-4.456**	**-4.404**
Movement in CFR represented by				
Net financing need for the year (above)	8.044	1.000	1.000	1.000
HRA Settlement	33.800	-	-	-
Less MRP General Fund	-3.433	-3.569	-3.603	-3.579

MRP PFI and Finance leases	-2.125	-1.802	-1.291	-1.263
MRP Housing	-0.490	-0.562	-0.562	-0.562
Movement in CFR	**35.796**	**-4.933**	**-4.456**	**-4.404**

MRP Policy Statement

26. The Council is required to pay off an element of the accumulated General Fund (CFR) each year through a revenue charge (the minimum revenue provision **-** MRP). It is also allowed to undertake additional voluntary payments if desired (voluntary revenue provision **-** VRP).

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

28. It is proposed that Darlington Borough Council's MRP Policy will be

    (a) For capital expenditure incurred before 1st April 2008 and future expenditure supported through the revenue support grant – Existing Practice - MRP will follow the existing practice outlined in the former CLG Regulations. This method is based on 4% of the opening balance sheet non-housing CFR but allows for adjustments to the calculation based on figures prior to the implementation of the prudential code.

    (b) From 1st April 2008 for all unsupported borrowing- Asset life Method - MRP will be based on the estimated life of the assets in accordance with the proposed regulations. Repayments will be made on either an annuity basis or a straight line basis.

    (c) Repayments relating to finance leases including the PFI scheme will be made in accordance with the principal repayments embedded in the lease scheme over the life of the lease.

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

Affordability Prudential Indicators

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

Estimates of the ratio of financing costs to net revenue stream.

31. This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

Table 7 - Ratio of financing costs to net revenue stream

	2011/12 Estimate %	2012/13 Estimate %	2013/14 Estimate %	2014/15 Estimate %
General Fund (excluding Direct Schools Grant)	4.13	7.61	7.45	7.13
HRA (inclusive of settlement)	8.42	23.28	22.46	21.86

32. Estimates for previous years have been provided for General Fund on the basis of including Direct Schools Grant. This grant funding is uncertain for future years as more schools convert to Academies, so to keep consistency going forward this has been excluded for future years.

33. The HRA figures include the financing costs related to the £33.800M borrowed for the self–financing settlement.

34. The estimates of financing costs include current commitments and the proposals in this years MTFP report. Once the figures have been adjusted in 2012/13 for the reasons set out above they continue to travel in a downward trend for future years.

Estimates of the incremental impact of capital investment decisions on council tax.

35. This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in the MTFP report compared to the Council's existing approved commitments and current plans. The assumptions are based on £1.000m of prudential borrowing each year over the life of the MTFP.

Table 8 Incremental impact of *new* capital investment decisions on the band D council tax-

	2011/12 Estimate £	2012/13 Estimate £	2013/14 Estimate £	2014/15 Estimate £
Council tax - band D	Nil	0.57	3.16	5.74

Estimates of the incremental impact of *new* capital investment decisions on housing rent levels.

36. Similar to the council tax calculation, this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in this budget report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

Table 9 - Incremental impact of capital investment decisions on housing rent levels

	2011/12 Estimate £	2012/13 Estimate £	2013/14 Estimate £	2014/15 Estimate £
Weekly housing rent levels	Nil	Nil	Nil	Nil

37. This indicator shows the revenue impact on any newly proposed changes. Although the Housing revenue account will now have increased financing charges due to the self-financing the annual cost of this is offset by the loss of payments to the Government for the Subsidy system. Housing rent levels are set by a different mechanism unaltered by the self financing regime.

Treasury Management Strategy

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

Current Portfolio Position

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

Table 10 - Net Borrowing to CFR

	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m	2014/15 Estimate £m
Debt at 1 April	81.000	81.000	81.000	81.000
HRA settlement	33.800	33.800	33.800	33.800
Other long-term liabilities (OLTL)	21.898	20.100	18.900	17.600
Actual debt at 31 March	**136.698**	**134.900**	**133.700**	**132.400**
The Capital Financing Requirement from Table 5	**177.308**	**172.375**	**167.919**	**163.515**
Under / (over) borrowing	**40.610**	**37.475**	**34.219**	**31.115**
Investments	**15.000**	**15.000**	**15.000**	**15.000**
Net Borrowing (Actual Debt less investments	**121.698**	**119.900**	**118.700**	**117.400**

40. Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its total debt, net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2012/13 and the following two financial years (shown as net borrowing above). This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

41. The Director of Resources reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this year's MTFP report.

Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary.

42. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Table 11 - Operational Boundary

	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m	2014/15 Estimate £m
Debt	81.000	79.000	79.000	79.000
Add HRA settlement	33.800	33.800	33.800	33.800
Other long term liabilities	21.898	20.100	18.900	17.600
Prudential Borrowing for leasable assets	0	1.000	1.000	1.000
Prudential Borrowing under Directors Delegated Powers	0	1.000	1.000	1.000
Operational Boundary	136.698	134.900	133.700	132.400

The Authorised Limit for external debt.

43. A further key prudential indicator represents a control on the maximum level of debt. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.
    (a) This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
    (b) The Council is asked to approve the following Authorised Limit:

Table 12 – Authorised Limit

	2011/12 Estimate £m	2012/13 Estimate £m	2013/14 Estimate £m	2014/15 Estimate £m
Operational Boundary	136.698	134.900	133.700	132.400
Additional Headroom as a % of Operational Boundary	10%	10%	10%	10%
Authorised Limit	150.368	148.390	147.070	145.640

44. Separately the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently £74.889M and is included within both the Operational Boundary and the Authorised Limit:

Table 13 – HRA Debt Limit

	2011/12 Estimate £m	**2012/13 Estimate £m**	**2013/14 Estimate £m**	**2014/15 Estimate £m**
Total	74.889	74.889	74.889	74.889

Prospects for Interest Rates

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

Table 14 - Interest Rate Forecast

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

Economic Outlook provided by Sector (Appendix 2 contains additional detail)

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

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

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

48. This challenging and uncertain economic outlook has a several key treasury mangement implications:
    (a) The Eurozone sovereign debt difficulties, most evident in Greece, provide a clear indication of much higher counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods;

    (b) Investment returns are likely to remain relatively low during 2012/13;

    (c) Borrowing interest rates are currently attractive, but may remain low for some time. The timing of any borrowing will need to be monitored carefully;

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

Borrowing Strategy

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

50. Against this background and the risks within the economic forecast, caution will be adopted with the 2012/13 treasury operations. The Director of Resources will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

    (a) if it was felt that there was a significant risk of a sharp FALL in long and short term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

(b) if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

51. The requirement for the HRA reform settlement to be made to the CLG on 28 March 2012 will require a separate consideration of a borrowing strategy. The Council will need to have the cash settlement amount of £33.800m 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 it meets the requirements of the HRA business plan and the overall requirements of the Council. Whilst the debt can be drawn earlier than needed, this will incur a revenue cost, and will not benefit from the preferential rates from PWLB so it is unlikely that the debt will be taken earlier than 28th March 2012.

Treasury Management Limits on Activity

52. There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

(a) Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments

(b) Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;

(c) Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits. The Council is asked to approve the following treasury indicators and limits:

Table 15 Interest Rate Exposure

	2012/13	**2013/14**	**2014/15**
	Upper	**Upper**	**Upper**

Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	40%	40%	40%
Maturity Structure of fixed interest rate borrowing 2012/13			
		Lower	**Upper**
Under 12 months		0%	25%
12 months to 2 years		0%	40%
2 years to 5 years		0%	60%
5 years to 10 years		0%	80%
10 years and above		0%	100%

Policy on Borrowing in Advance of Need

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

Debt Rescheduling

54. As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

55. The reasons for any rescheduling to take place will include:

    (a) the generation of cash savings and / or discounted cash flow savings;

    (b) helping to fulfil the treasury strategy;

    (c) enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

56. Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

Annual Investment Strategy

Investment and Creditworthiness Policy

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

58. In accordance with the above, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings and watches published by all three ratings agencies with a full understanding of what the ratings reflect in the eyes of each agengy. Using the Sector ratings service banks' ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

59. Further, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "Credit Default Swaps" and overlay that information on top of the credit ratings. This is encapsulated within the credit methodology provided by the advisors, Sector.

60. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

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

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

63. Investment instruments identified for use in the financial year are listed in **Appendix 3** under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

Investment Counterparty Selection Criteria

64. 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:

    (a) 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; and

    (b) It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

65. The Director of Resources will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either Specified or Non-Specified (See appendix 3 for definitions) as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

66. The rating criteria use the **lowest common denominator** method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria. This is in compliance with a CIPFA Treasury Management Panel recommendation in March 2009 and the CIPFA Treasury Management Code of Practice.

67. Credit rating information is supplied by Sector, our treasury consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

68. The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) is:

    (a) Banks 1 - good credit quality **–** the Council will only use banks which:

i. are UK banks; and have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):

i. Short term – F1

ii. Long term – A-

iii. Viability / financial strength – bb+ (Fitch / Moody's only)

iv. Support – 3 (Fitch only)

(b) Banks 2 – Part nationalised UK banks – Lloyds Bank and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.

(c) Banks 3 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.

(d) Building societies The Council will use all societies which:

i. meet the ratings for banks outlined above and have assets in excess of £1,000m

(e) Money Market Funds – AAA

(f) UK Government (including gilts Treasury Bills and the DMADF)

(g) Local authorities, parish councils etc

(h) Supranational institutions

69. A limit of £10M will be applied to the use of Non-Specified investments.

Use of additional information other than credit ratings

70. Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

Time and monetary limits applying to investments.

71. The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both Specified and Non-Specified Investments):

72. In order to determine time limits for investments the Council applies the creditworthiness service provided by Sector. This service employs a sophisticated modelling approach utlilising credit ratings from the three main credit rating agencies - Fitch, Moodys and Standard and Poors. The credit ratings of counterparties are supplemented with the following overlays:

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

73. The Council will therefore use the following durational bands when applying time limits to investments

(a) Yellow 5 years *This only relates to AAA rated government debt or its equivalent

(b) Purple 2 years

(c) Blue 1 year (only applies to nationalised or semi nationalised UK Banks)

(d) Orange 1 year

(e) Red 6 months

(f) Green 3 months

Table 16 – Time and monetary limits applying to investments

	Fitch Long term Rating (or equivalent)	Money Limit	Time Limit
Banks 1 category high quality	**AA-**	**£5m**	**Suggested duration using Sector colour coding (CDS adjusted with manual override)**
Banks 1 category lower quality	**A-**	**£3m**	**Suggested duration using Sector colour coding (CDS adjusted with manual override)**
Banks 2 category – part nationalised	**N/A**	**£3m**	**Suggested duration using Sector colour coding (Watch/Outlook adjusted)**
Limit 3 category – Council's banker (not meeting Banks 1and 2)		**£3m**	**1 day**
DMADF (Debt Management Office)	**AAA**	**unlimited**	**6 months**
Local authorities	**N/A**	**£5m**	**1 yr**
Money market Funds	**AAA**	**£5m**	**liquid**

74. The proposed criteria for Specified and Non-Specified investments are shown in Appendix 3 or approval.

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

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

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

Investment Strategy

In-house funds.

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

Investment returns expectations

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

    (a) 2011/ 2012 0.50%
    (b) 2012/ 2013 0.50%
    (c) 2013/ 2014 1.25%
    (d) 2014/ 2015 2.50%

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

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

    (a) 2012/13 0.70%

(b) 2013/14 1.00%
(c) 2014/15 1.60%
(d) 2015/16 3.30%
(e) 2016/17 4.10%

Investment treasury indicator and limit

81. Total principal funds invested for greater than 364 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

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

Table 17 – Maximum Principal sums invested

	2012/13	**2013/14**	**2014/15**
Principal sums invested greater than 364 days	£10m	£10m	£10m

83. For its cash flow generated balances, the Council will seek to utilise its business reserve accounts, 15 and 30 day notice accounts, money market funds and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

Investment Risk Benchmarking

84. These benchmarks are simple guides to maximum risk, so they 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 to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

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

- **0.077% historic risk of default when compared to the whole portfolio.**

Liquidity – in respect of this area the Council seeks to maintain:

(a) Bank overdraft - £0.100m
(b) Liquid short term deposits of at least £3.000m available with a week's notice.
(c) Weighted Average Life benchmark is expected to be 0.4 years, with a maximum of 1 year.

86. Yield - local measures of yield benchmarks are
(a) *:* Investments – Short Term- cashflow investment rate returned against comparative interest rates

(b) Investments – Longer term – capital investment rates returned against comparative average rates

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

Table 18 - Security Benchmark

	1 year	2 years
Maximum	**0.077%**	**0.059%**

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

End of year investment report

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

Policy on the use of external service providers

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

(a) Technical support on treasury matters, capital finance issues and the drafting of Member reports;

(b) Economic and interest rate analysis;

(c) Debt services which includes advice on the timing of borrowing;

(d) Debt rescheduling advice surrounding the existing portfolio;

(e) Generic investment advice on interest rates, timing and investment instruments;

(f) Credit ratings from the three main rating agencies and other market information on counterparties.

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

91. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

Outcome of Consultation

92. No consultation was undertaken in the production of this report.

APPENDIX 1 Interest Rate Forecast 2011/12

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

APPENDIX 2
Economic Background

Global economy

1. The outlook for the global economy remains clouded with uncertainty with the UK economy struggling to generate sustained recovery that offers any optimistim for the outlooks for 2011 and 2012, or possibly even into 2013. Consumer and business confidence levels are low and with little to boost sentiment, it is not easy to see potential for a significant increase in the growth rate in the short term.
2. At the centre of much of the uncertainty is the ongoing **Eurozone sovereign debt crisis** which has intensified, rather than dissipated throughout 2011. The main problem has been **Greece**, where, even with an Eurozone/IMF/ECB bailout package and the imposition of austerity measures aimed at deficit reduction, the lack of progress and the ongoing deficiency in addressing the underlying lack of competitiveness of the Greek economy, has seen an escalation of their problems. These look certain to result in a default of some kind but it currently remains unresolved if this will be either “orderly” or “disorderly”, and/or also include exit from the €uro bloc.
3. As if that were not enough there is growing concern about the situation in **Italy** and the risk that contagion has not been contained. Italy is the third biggest debtor country in the world but its prospects are limited given the poor rate of economic growth over the last decade and the lack of political will to address the need for fundamental reforms in the economy. The Eurozone now has a well established track record of always doing too little too late to deal with this crisis; this augurs poorly for future prospects, especially given the rising level of electoral opposition in northern EU countries to bailing out profligate southern countries.

US economy

4. The US economy ffers little to lift spirits. With the next Presidential elections due in November 2012, the current administration has been hamstrung by political gridlock with the two houses split between the main parties. In quarter 3 the Federal Reserve started “Operation Twist” in an effort to re-ignite the economy in which growth is stalling. High levels of consumer indebtedness, unemployment and a moribund housing market are weighing heavily on consumer confidence and so on the abiltity to generate sustained economic growth.
5. Hopes for broad based recovery have, therefore, focussed on the **emerging markets** but these areas have been struggling with inflationary pressures in their previously fast growth economies. China, though, has maintained its growth pattern, despite tightening monetary policy to suppress inflationary pressures, but some forward looking indicators are causing concern that there may not be a soft landing ahead, which would then be a further dampener on world economic growth.

UK economy

6. The Government’s austerity measures, aimed at getting the public sector deficit into order over the next four years, have yet to fully impact on the economy.

However, coming at a time when economic growth has virtually flatlined and concerns at the risk of a technical recession (two quarters of negatibe growth) in 2012, it looks likely that the private sector will not make up for the negative impact of these austerity measures given the lack of an export led recovery due to the downturn in our major trading partner – the EU. The housing market, a gauge of consumer confidence, remains weak and the outlook is for house prices to be little changed for a prolonged period.

Economic Growth.

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

Unemployment.

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

Inflation and Bank Rate.

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

AAA rating.

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

Sector's forward view

11. Economic forecasting remains troublesome with so many extermal influences weighing on the UK. There does, however, appear to be consensus among analysts that the economy remains weak and whilst there is still a broad range of views as to potential performance, they have all been downgraded throughout 2011. Key areas of uncertainty include:
    (a) a worsening of the Eurozone debt crisis and heightened risk of the breakdown of the bloc or even of the currency itself;

(b) the impact of the Eurozone crisis on financial markets and the banking sector;

(c) the impact of the Government's austerity plan on confidence and growth and the need to rebalance the economy from services to exporting manufactured goods;

(d) the under-performance of the UK economy which could undermine the Government's policies that have been based upon levels of growth that inceasingly seem likely to be undershot;

(e) a continuation of high levels of inflation ;

(f) the economic performance of the UK's trading partners, in particular the EU and US, with some analysts suggesting that recession could return to both;

(g) stimulus packages failing to stimulate growth;

(h) elections due in the US, Germany and France in 2012 or 2013;

(i) potential for protectionism i.e. an escalation of the currency war / trade dispute between the US and China.

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

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

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

APPENDIX 3 –

Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

1. The CLG issued Investment Guidance in 2010, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime.

2. The key intention of the Guidance is to maintain the current requirement for Councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the Code on 21st March 2002 and will apply its principles to all investment activity. In accordance with the Code, the Director of Resources has produced its Treasury Management Practices (TMPs). This part, TMP 1(5), covering investment counterparty policy requires approval each year.

Annual Investment Strategy

3. The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

    (a) The strategy guidelines for choosing and placing investments, particularly non-specified investments.

    (b) The principles to be used to determine the maximum periods for which funds can be committed.

    (c) Specified investments that the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.

    (d) Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Council is:

Strategy Guidelines

4. The main strategy guidelines are contained in the body of the treasury strategy statement.

All Investments

5. The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) is:

(a) Banks 1 - good credit quality **–** the Council will only use banks which:

i. are UK banks; and have, as a minimum, the following Fitch, Moody’s and Standard and Poors credit ratings (where rated):

ii. Short term – F1

iii. Long term – A-

iv. Viability / financial strength – bb+ (Fitch / Moody’s only)

v. Support – 3 (Fitch only)

(b) Banks 2 – Part nationalised UK banks – Lloyds Bank Group and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
(c) Banks 3 – The Council’s own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
(d) Building societies The Council will use all societies which:

ii. meet the ratings for banks outlined above and have assets in excess of £1,000m

(e) Money Market Funds – AAA
(f) UK Government (including gilts Treasury Bills and the DMADF)
(g) Local authorities, parish councils etc
(h) Supranational institutions

Specified Investments

6. These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

(a) The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
(b) Supranational bonds of less than one year’s duration.
(c) A local authority, parish council or community council.
(d) Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category d this covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor’s, Moody’s or Fitch rating agencies.
(e) A body that is considered of a high credit quality (such as a bank or building society). For category e this covers bodies with a minimum short term

rating of F1 (or the equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies.

7. Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies. is

	Fitch Long term Rating (or equivalent)	Money Limit	Time Limit
Banks 1 category high quality	**AA-**	**£5m**	**Suggested duration using Sector colour coding (CDS adjusted with manual override)**
Banks 1 category lower quality	**A-**	**£3m**	**Suggested duration using Sector colour coding (CDS adjusted with manual override)**
Banks 2 category – part nationalised	**N/A**	**£3m**	**Suggested duration using Sector colour coding (Watch/Outlook adjusted)**
Limit 3 category – Council's banker (not meeting Banks 1and 2)		**£3m**	**1 day**
DMADF	**AAA**	**unlimited**	**6 months**
Local authorities	**N/A**	**£5m**	**1 yr**
Money market Funds	**AAA**	**£5m**	**liquid**

8. The Council will therefore use the following durational bands supplied by Sectors creditworthiness service when applying time limits to investments

(j) Yellow 5 years *This only relates to AAA rated government debt or its equivalent
(k) Purple 2 years
(l) Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
(m) Orange 1 year
(n) Red 6 months
(o) Green 3 months

Non-Specified Investments –

9. Non-specified investments are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investments would include any sterling investments with:

	Non Specified Investment Category	Limit (£ or %)
a.	**Supranational Bonds greater than 1 year to maturity** **(a) Multilateral development bank bonds -** These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Investment Bank etc.). **(b) A financial institution that is guaranteed by the United Kingdom Government** (e.g. The Guaranteed Export Finance Company {GEFCO}) The security of interest and principal on maturity is on a par with the Government and so very secure. 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.	AAA long term ratings
b.	**Gilt edged securities** with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	
c.	**The Council's own banker if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.**	£3M
d.	Any **bank or building society** that has a minimum long term credit rating of AA- or equivalent, for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	£10M in total

10. Within categories c and d, and in accordance with the Code, the Council has developed additional criteria to set the overall amount of monies which will be invested in these bodies. Time limits will be applied to banks using the creditworthiness service provided by Sector.

The Monitoring of Investment Counterparties

11. The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Sector as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Director of Resources, and if required new counterparties which meet the criteria will be added to the list.