
PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT STRATEGY
REPORT 2010/2011

Responsible Cabinet Member - Councillor Chris McEwan,
Efficiency & Resources Portfolio

Responsible Director - - Paul Wildsmith, Director of Corporate Services

SUMMARY REPORT

Purpose of the Report

1. This report requests Council to adopt the following:-
 - (a) The Prudential Indicators and Limits for 2010/11 to 2012/13 relating to capital expenditure and Treasury Management activity
 - (b) A policy statement relating to the Minimum Revenue Provision (MRP)
 - (c) The Treasury Management Strategy 2010/11, which includes the Investment Strategy for 2010/11.

Summary

2. This report outlines the Council's prudential indicators for 2010/11 to 2012/13 and sets out the expected treasury operations for this period. It fulfils four key legislative 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 the 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 Council could afford in the short term, but which would not be sustainable in the longer term.
 - (e) The **investment strategy** which sets out the Council's criteria for choosing investment counterparties and limiting exposure to the risk of loss.
3. The information contained in the report regarding the Council's capital expenditure plans, treasury Management and Prudential Borrowing activities indicates 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 22nd January 2010 under their responsibilities for ensuring effective scrutiny of the treasury management and policies. The Committee was satisfied with the Prudential Indicators and Treasury Management Strategy as presented in this report. Furthermore the Audit Committee requested that the results of the new Security, Liquidity and Yield benchmarking results be taken to future meetings of the Audit Committee

Recommendation

5. The following is recommended for approval by Council
 - (a) The Prudential Indicators and limits for 2010/11 to 2012 as summarised in Tables 1 and 2.
 - (b) The Minimum Revenue Provision (MRP) statement contained within paragraph 27
 - (c) The Treasury Management Strategy 2010/11 – 2012/13 in paragraphs 40 to 59
 - (d) The Investment Strategy 2010/11 contained in paragraphs 60 to 76
 - (e) The revision to the Council's Constitution at Appendix 1

Reasons

6. The recommendations are supported for 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 Corporate Services

Background Papers

Annual Statement of Accounts 2008/09
Draft Capital MTFP 2010/11 to 2012/13

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
Sustainability	This report has no implications for the Councils Sustainability agenda
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 report must be considered by Council
Urgent Decision	This report must be considered by Council
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

7. This budgetary cycle provides for the seventh full year of operation of the CIPFA Prudential code. The Prudential Code operates by the provision of prudential indicators, which highlight aspects of the capital expenditure planning. Each indicator provided during the 2009/10 budget process has been updated and provided for the next three years. These are detailed below. This is in accordance with the Prudential Code, which requires that Council approve certain mandatory indicators.
8. The purpose of the indicators is to provide a framework for capital expenditure decision-making. The prudential indicators highlight the level of capital expenditure; the impact on borrowing and investment levels and the overall controls in place to ensure the activity remains affordable, prudent and sustainable.
9. Capital expenditure decisions impact on the Council's treasury management activity, either through increased borrowing levels or the application of investment balances. Consequently the Treasury Management Strategy for 2010/11 is included in this report. This report also includes the Treasury Management Prudential Indicators. The production of the Treasury Management Strategy is a requirement of the CIPFA Code of Practice on Treasury Management.
10. In addition, part of the Treasury Management Strategy requirements is the formulation of an investment strategy. Investment guidance issued by the CLG during March 2004 overlaps into the Code of Practice requirements. The reporting requirements of the CLG guidance have therefore been incorporated into the Treasury Management Strategy.
11. Revised editions of the CIPFA Prudential Code and CIPFA Treasury Management Code of Practice were produced in November 2009 and the CLG is currently consulting on changes to the Investment Guidance. The revised guidance arising from these Codes has been incorporated within these reports, with the CLG proposals being incorporated where they do not conflict with current Guidance. If necessary the Investment Strategy contained in paragraphs 60 to 76 will be revised if any elements of the final CLG Investment Guidance have not already been covered.
12. The main changes initiated in the revisions increase the Members responsibility in this area. This requires greater scrutiny of the treasury policies, increased Member training and awareness and greater frequency of information.
13. As a result this report is being considered by the Audit Committee and Members were invited to attend two training sessions in November/ December 2009 on the Prudential Code and the Treasury Management Policy and Strategy.
14. One element of the revised CIPFA Treasury Management Code of Practice is that the clauses to be adopted as part of the Councils constitution be amended. This revision is shown at **Appendix 1** for approval. The key change is that a responsible body (Audit Committee) be responsible for ensuring the effective scrutiny of the Treasury Management Strategy and policies before making recommendations to Council via Cabinet.

15. The above policies and parameters provide an approved framework within which the officers undertake the day to day capital and treasury activities.
16. The Local Government Act 2003 requires the Council to adopt the CIPFA Prudential Code and produce prudential indicators. Each indicator either summarises the expected capital activity or introduces limits upon that activity, and reflects the outcome of the Council's Draft Capital Medium Term Financial Plan.
17. Within this overall prudential framework there is an impact on the Council's treasury management activity, as it will directly impact on borrowing or investment activity. As a consequence the Treasury Management strategy for 2010/11 to 2012/13 is included in Paragraphs 40 to 80 to complement these indicators. Some of the prudential indicators are shown in the treasury management strategy to aid understanding.
18. A summary of the key prudential indicators and limits are contained in **Tables 1 and 2**

Table 1 – Capital Expenditure and Borrowing

	2009/10 Revised	2010/11 Estimated	2011/12 Estimated	2012/13 Estimated
	£m	£m	£m	£m
Capital Expenditure	44.559	70.278	43.913	38.776
Capital financing requirement	140.545	147.639	146.700	142.909
Operational boundary for external debt	114.339	122.799	146.294	149.822
Authorised limit for external debt	125.772	135.079	160.923	164.804
Ratio of financing costs to net revenue stream – General Fund	4.62%	4.70%	5.30%	4.61%
Ratio of financing costs to net revenue stream – HRA	10.15%	12.47%	12.39%	11.95%
Incremental impact of new capital investment decisions on the band D Council Tax		0.58	3.44	5.21
Incremental impact of new capital investment decisions on Housing Rents levels		Nil	Nil	Nil

Table 2 – Treasury Management

	2010/11 Upper Limit	2011/12 Upper Limit	2012/13 Upper Limit
Limits on fixed interest rates	100%	100%	100%
Limits on variable interest rates	40%	40%	40%
Maturity Structure of fixed interest rate borrowing			
	Upper Limit	Upper Limit	Upper Limit
Under 12 months	25%	25%	25%
12 months to 2 years	40%	40%	40%
2 years to 5 years	60%	60%	60%
5 years to 10 years	80%	80%	80%
10 years and above	100%	100%	100%
Maximum principal sums invested > 364 days	£10M	£10M	£15M

The Council's Capital Expenditure Plans

19. The Council's Capital Expenditure plans as outlined in the draft Medium Term Financial Plan (MTFP) for Capital will be partly financed by resources such as capital grants capital contributions and capital receipts etc. The remaining element, which cannot be immediately financed from other sources will impact on the Council's underlying need to borrow, called the Capital Financing Requirement (CFR). The summary of capital expenditure and the impact on the CFR are shown in **Tables 3 and 4** below. The figures included in these tables represent the forecasted capital programme in Appendix 15 of the Draft Corporate Medium Term Financial Plan adjusted for any slippage from previous years Corporate Capital Programme. This forms one of the required Prudential Indicators. A more detailed analysis, breaking down the General Fund and the Housing Revenue Account split is shown in **Appendix 2**
20. A certain level of borrowing will be supported by Government through the Revenue Support Grant. Any borrowing above this level will be unsupported and will need to be financed from the Council's own resources.
21. The limiting factors on the Council's ability to undertake unsupported capital expenditure is the availability of
- (a) Revenue resources to support in full the implications of capital expenditure, both borrowing and ongoing running costs i.e. Can the Council afford the implications of the unsupported borrowing.

- (b) The Government has reserve powers to implement specific limits on the Council's capital expenditure plans. No such limits were implemented in the past five years and there is no indication of such controls in 2010/11

22. A risk of the plan is the level of government support has some estimates included over the life of the plan some of this relates to timing of grants and some relates to the amount of grant and is therefore subject to change. Similarly some of the estimates for other sources of funding such as capital receipts may be subject to change over this timescale. The Council reviews and adjusts its capital plans annually, taking account of changes in projected future years' resources. Anticipated asset sales will again be postponed until the property market improves.
23. The Council is asked to approve the capital expenditure projections below. Service details are in **Appendix 2** and further details of capital expenditure are contained in the Draft Capital MTFP report. This forms the first prudential indicator

Table 3

	2009/10 Revised	2010/11 Estimate	2011/12 Estimate	2012/13 Estimate
	£m	£m	£m	£m
Capital Expenditure				
Total Expenditure	44.559	70.278	43.913	38.776
Financed by				
Capital Receipts	0.360	1.350	0.950	0.950
Capital Grants	27.453	53.627	36.350	33.829
Capital Contributions	1.620	0.702	0.0	0.0
Revenue	2.868	1.971	2.013	1.792
Total Financing other than borrowing	32.301	57.650	39.313	36.571
Net financing need for the year	12.258	12.628	4.600	2.205

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

24. The second prudential indicator is the Councils Capital Financing Requirement (CFR). The CFR is simply the total outstanding capital expenditure which has not yet been paid for by either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. The capital expenditure above which has not immediately been paid for will increase the CFR.
25. The Prudential Indicators produced in previous years have been based on the compilation of the authority's accounts under UK GAAP Accounting Standards. During 2009/10 and 2010/11 local authorities will start to compile their accounts under International Financial Reporting Standards (IFRS). Some assets that are currently off balance such as the PFI scheme for the Education Village and Harrowgate Hill School will come on the balance sheet along with the reclassification of some of the Councils leases. This will increase the CFR on the balance sheet as this is expenditure for capital assets which is yet to be paid for. There will be no increase on revenue accounts resulting from this as charges relating to these assets are already included in the MTFP and have been for a number of years. Table 4 identifies the CFR relating to IFRS accounting entries separately.

26. The Council is asked to approve the CFR projections below

Table 4

	2009/10 Revised	2010/11 Estimate	2011/12 Estimate	2012/13 Estimate
	£m	£m	£m	£m
Capital Financing Requirement				
CFR – General Fund	79.428	81.809	81.131	79.478
CFR- General Fund PFI IFRS	26.479	24.939	23.434	21.962
Total CFR General Fund	105.907	106.748	104.565	101.440
CFR – Housing	34.638	40.891	42.135	41.469
Total CFR	140.545	147.639	146.700	142.909
Net movement in CFR	35.459	7.094	-0.939	-3.791
Movement in the CFR represented by				
Net financing need for the year from Table 3	12.258	12.628	4.600	2.205
MRP/VRP	-3.278	-3.994	-4.034	-4.524
CFR General Fund relating to PFI IFRS	26.479	-1.540	-1.505	-1.472
Movement in CFR	35.459	7.094	-0.939	-3.791

Minimum Revenue Provision Policy statement

27. The Council is required to charge to its revenue account each year a provision to pay off an element of the accumulated General Fund capital debt (the Minimum Revenue Provision-MRP). The Council may also make additional voluntary revenue provision(VRP) to further reduce the CFR.
28. CLG regulations require the Council to approve an MRP Policy Statement. This will need to be approved in advance of each year. Whilst the regulations revoke current MRP requirements, Councils are allowed to continue historical accounting practice for all capital borrowing incurred prior to 1st April 2008. However, in order to ensure that Local Authorities prudently repay debt incurred in later years, this method of calculation for MRP will only relate to supported capital expenditure that is funded through Revenue Support Grant. Debt that is incurred for unsupported borrowing will have to be repaid over the life of the asset to which the capital expenditure relates.
29. It is proposed that Darlington borough Councils 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

30. The expected impact of the capital expenditure decisions on the Councils debt and investment position is shown below :-

Table 5 Net Borrowing to CFR

	2009/10 Revised	2010/11 Estimate	2011/12 Estimate	2012/13 Estimate
	£m	£m	£m	£m
Borrowing	85.860	95.860	120.860	125.860
Less Investments	-20.000	-25.000	-37.500	-50.000
Net Borrowing	65.860	70.860	83.360	75.860
CFR (from Table 4)	140.545	147.639	146.700	142.909

TABLE 5a Local Indicator showing Net Borrowing plus commitments under IFRS for PFI etc.

	2009/10 Revised	2010/11 Estimate	2011/12 Estimate	2012/13 Estimate
	£m	£m	£m	£m
Borrowing	85.860	95.860	120.860	125.860
Add IFRS PFI/leased assets (from table 4)	26.479	24.939	23.434	21.962
Less investments	-20.000	-25.000	-37.500	-50.000
Total borrowing including IFRS PFI and leased assets	92.339	95.799	106.794	97.822
CFR (from Table 4)	140.545	147.639	146.700	142.909

31. Early in 2009/10 because of the current economic conditions a decision was taken to reduce actual debt by using investments to repay debt. This decision had 2 advantages
- (a) it reduced the risk of investing with a counterparty (ie Bank or Building Society) that might not be able to honour its commitments and repay investments when they become due and
 - (b) it reduced annual financing costs as the interest rate paid on debt is currently greater than the interest rate returned on investments.
32. The estimates above in **Table 5** assume that over the years 2010/11 to 2012/13 the economic climate will change as counterparties become stronger and rates of return on investments increase allowing the councils borrowing and investment levels return to those experienced prior the economic downturn. Financing Costs within the draft MTFP reflect these expected levels of actual debt and investments.

Limit to Borrowing Activity

33. Within the prudential indicators there are a number of key indicators to ensure the Council operates its activities within well-defined limits.
34. For the first of these the Council needs to ensure that its total borrowing net of any investments does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2009/10 and next two financial years. This allows some flexibility for limited early borrowing for future years.
35. The Council will comply with the prudential indicator requirement to keep borrowing below the relevant CFR in the current year and table 5 confirms that no difficulties are envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the draft Revenue and Capital MTFP's

Affordability Prudential Indicators

36. 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.
37. **Actual and estimates of the Ratio of Financing Costs to net revenue stream** – This indicator identifies the trend in the cost of capital (borrowing costs net of investment income) against the net revenue stream.

Table 6 - Ratio of financing costs to net revenue stream

	2009/10 Revised	2010/11 Estimate	2011/12 Estimate	2012/13 Estimate
General Fund	2.51%	2.72%	3.41%.	2.82%
General Fund including IFRS changes	4.62%	4.70%	5.30%	4.61%
HRA	10.15%	12.47%.	12.39%	11.95%

38. The estimates of financing costs include current commitments and the proposals in the draft MTFP
39. **Estimates of the incremental impact of capital investment decisions on the Council Tax** - This indicator identifies the trend in the cost of proposed changes in the three year capital programme recommended in this budget report compared to the Council's existing commitments and current plans, and therefore relates to *new schemes* within this MTFP round. The Corporate Medium Term Financial Plan proposes new schemes amounting to £2.200M over the life of the MTFP only, to be paid using corporate prudential borrowing/capital receipts, the incremental impact of that proposal on Council Tax Band D is shown below. In addition to that there may also be some departmental unsupported borrowing to be undertaken in the form of 'invest to save' schemes and replacing leased

assets i.e. computer equipment with assets paid for by prudential borrowing, the repayment of this borrowing will be accommodated within Departmental resource allocations, which will therefore have no incremental effect on Council Tax.

Table 7 – Incremental impact of *new* capital investment decisions on the Band D Council Tax

	Proposed Budget 2010/11 £	Forward Projection 2011/12 £	Forward Projection 2012/13 £
Incremental impact of new capital investment decisions on the Band D Council Tax.	0.58	3.44	5.21

40. **Estimates of the incremental impact of capital investment decisions on Housing Rent levels** – Similar to the Council tax calculation this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in this budget report, compared to the Council’s existing commitments and current plans, expressed as a change in weekly rent levels. In July 2004 Council approved a decision to prudentially borrow up to £20m over six years to invest in Council Housing in order to meet the Decent Homes Standard. However, the additional repayment costs of the debt incurred are to be accommodated within the Housing Revenue Account resources, the increased financing charges will be compensated by a reduction in other management costs, therefore, there is to be no incremental effect on housing rent levels. In addition to this new borrowing is anticipated for the new build but additional rent income from these properties will cover these financing costs

Table 8 – Incremental impact of capital investment decisions Housing Rent levels

	Proposed Budget 2010/11 £	Forward Projection 2011/12 £	Forward Projection 2012/13 £
Weekly Housing Rents	Nil	Nil	Nil

Treasury Management Strategy 2010/11 – 2012/13

41. The Treasury Management service is an important part of the overall financial management of the Council’s affairs. Its importance has increased as a result of the freedoms provided by the Code. It covers the borrowing and investment activities and the effective management of associated risks. Whilst the prudential indicators above consider the affordability and impact of capital expenditure decisions, the treasury management service covers the effective funding of these decisions. There are also specific treasury management prudential indicators included in this strategy which 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
42. The Council’s activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management –revised November

2009). This Council adopted the Code of Practice on Treasury Management on 21st March 2002 (Min. Ref. 63/Mar/2002 refers) and will adopt the revised Code at Special Council during February 2010 when the MTFP will be approved.

43. As a result of adopting the Code the Council also adopted a Treasury Management Policy Statement (21/03/2002). This adoption meets the requirements of one of the prudential indicators. However the revised Code of Practice has amended the Treasury Management policy statement and this is appended at Appendix 1 for approval.
44. The Treasury Management Policy requires an annual strategy to be reported to Cabinet/ Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. A further treasury report is produced after the year-end to report on actual activity for the year, and a new requirement of the revised Code of Practice is that there is a mid-year monitoring report, however Cabinet/ Council of this authority have been advised by such a report for a number of years.
45. This Strategy covers:
 - (a) The Councils debt and investment projections;
 - (b) The Councils estimates and limits on future debt levels;
 - (c) The expected movements in interest rates
 - (d) The Council's borrowing and investment strategies;
 - (e) Treasury Management Performance indicators;
 - (f) Specific Limits on Treasury Management activities;
 - (g) Any local Treasury Management issues.

Debt and Investment Projections 2010/11 – 2012/13

46. The borrowing requirement comprises of the expected movement in CFR and any maturing debt which will need to be refinanced. The table 9 below shows this effect on the treasury position over the next three years. The expected maximum debt position during each year represents the Operational Boundary Prudential Indicator, and will be different from the year end position as it is adjusted to include estimated additional borrowing that may be required to cover Prudential borrowing for formerly leased assets, borrowing under Directors delegated powers and any additional supported borrowing that may be offered throughout the year.

Table 9- Operational Boundary

	2009/10 Revised	2010/11 Estimated	2011/12 Estimated	2012/13 Estimated
Market/ PWLB debt (Table 5)	85.860	95.860	120.860	125.860
Other Long Term Liabilities under IFRS ie Leases and PFI (Table 4)	26.479	24.939	23.434	21.962
Total External Debt at 1 st April	104.242	112.339	120.799	144.294
Expected Change in Debt	8.097	8.460	23.495	3.528
Debt at 31 st March	112.339	120.799	144.294	147.822
Add				
Estimated Additional Supported	0.500	0.500	0.500	0.500

Borrowing				
Prudential Borrowing for leasable assets	1.000	1.000	1.000	1.000
Prudential Borrowing under Directors delegated powers	0.500	0.500	0.500	0.500
Operational Boundary	114.339	122.799	146.294	149.822
Investments	39.900	20.000	25.000	37.500
Total Investments at 31 March	20.000	25.000	37.500	50.000
Investment Change	-19.900	5.000	12.500	12.500
Net Borrowing	94.339	97.799	108.794	99.822

Limits to Borrowing Activity

47. Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits.
48. For the first of these the Councils needs to ensure that its total borrowing net of any investments, does not except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2010/11 and the following two financial years (the relevant comparative figures are highlighted). This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue purposes.
49. Table 5 is repeated below to illustrate this indicator

Net Borrowing to CFR from Table5

	2009/10 Revised	2010/11 Estimate	2011/12 Estimate	2012/13 Estimate
	£m	£m	£m	£m
Net Borrowing	65.860	70.860	83.860	75.860
CFR (from Table 4)	140.545	147.639	146.700	142.909

50. The Director of Corporate Services reports that the Council complied with this prudential indicator in the current year and does not envisage any difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in the budget report.
51. **The Authorised Limit for External Debt** - A further key prudential indicator represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by 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
52. 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 no control has yet been exercised.
53. The Council is asked to approve the following Authorised Limit:

Table 10 Authorised Limit

	2009/10 Revised	2010/11 Estimate	2011/12 Estimate	2012/13 Estimate
Operational Boundary from table 9	114.339	122.799	146.294	149.822
Additional Headroom as a % of Operational Boundary	10%	10%	10%	10%
Authorised Limit	125.772	135.079	160.923	164.804

54. Borrowing in advance of need – The Council has some flexibility to borrow funds this year for use in future years. The Director of Corporate Services may do this under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. Whilst the Director of Corporate Services will adopt a cautious approach to any such borrowing, where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities. Any borrowing in advance will be made within the following constraints.
- It will be limited to no more than 50% of the expected increase in borrowing need (CFR) over the 3 year planning period; and
 - Would not look to borrow more than 6 months in advance of need.
55. The risks associated with any advance borrowing activity will be subject to appraisal in advance and subsequent reporting through the mid-year or annual reporting mechanism.

Expected movement in Interest Rates

56. There is always a risk to the Treasury Management Budget from adverse movement in interest rates. The Prudential Code is constructed on the basis of affordability, part of which relates to borrowing costs and investment returns. The Council employs Butlers, the treasury consultants, to advise on the Treasury Management Strategy, to provide economic data and interest rate forecasts, to assist planning and reduce unforeseen adverse movements. Butlers view of the UK and world economy and the effects this will have on the UK interest rates is attached at **Appendix 3** Forecast interest rates are summarised in Table 11

Table 11- Medium Term Rate forecast- Annual Average % (Source Butlers)

Year	Bank Rate	Investment Rates		PWLB Rates *		
		3 Month	1 Year	5 Year	20 Year	50 Year
2009/10	0.5	0.8	1.4	3.2	4.4	4.6
2010/11	1.0	1.5	2.3	4.0	5.0	5.2
2011/12	2.0	2.5	3.3	4.3	5.3	5.3
2012/13	4.5	4.8	5.3	5.3	5.5	5.3

Borrowing and Debt Strategy 2010/11 -2012/13

57. The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy.
58. Long- term fixed interest rates are at risk of being higher over the medium term, and short term rates are expected to rise, although modestly. The Director of Corporate Services, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time taking into account the risks shown in the forecast above. It is likely that shorter term fixed rates may provide lower cost opportunities in the short/ medium term.
59. With the likelihood of long term rates increasing, debt restructuring is likely to focus on switching from longer term fixed rates to cheaper shorter term debt, although the Director of Corporate Services and treasury consultants will monitor prevailing rates for any opportunities during the year.
60. The option of postponing borrowing and running down investments may continue in the short to medium term. This will continue to reduce counterparty risk whilst hedging against expected low investment returns.

Investment Strategy 2010/11-2012/13

61. **Key Objectives** – The Councils Investment Strategy primary objectives are safeguarding the repayments of the principal and interest of its investments on time first, and ensuring liquidity second, the investment return being the third objective. Following the economic background at present the current investment climate has one over-riding risk consideration, that of counterparty security. As a result of these underlying concerns officers are implementing an operational investment strategy which tightens the controls already in place in the approved investment strategy.
62. **Risk Benchmarking** – A development in the revised Codes and the CLG consultation paper is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are new requirements to Member reporting, although the application of these is more subjective in nature. Additional background in the approach taken is attached at **Appendix 4**
63. These benchmarks are simple targets (not limits) and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current 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.
64. Security - The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

0.03% historic risk of default when compared to the whole portfolio. Appendix 4 holds more details on this calculation
65. Liquidity – In respect of this area the Council seeks to maintain:
 - (a) Bank overdraft - £0.500m

- (b) Liquid short term deposits of at least £3m available within a weeks notice.
 - (c) Weighted Average Life benchmark is expected to be 0.5 years, with a maximum of 1.25 years.
66. Yield - Local measures of yield benchmarks are :
- (a) Investments – Short term – Cashflow investment rates returned against comparative rates
 - (b) Investments- Longer term – Capital investments rates returned against comparative average rates

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

Table 12

	1 year	2 years	3 years
Maximum	0.03%	0.00%	0.00%

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

68. **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:
- (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.
 - (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.
69. The Director of Corporate Services will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. This criteria is separate to that which chooses Specified and Non-Specified investments as it provides an overall pool of counterparties considered high quality the Council may use rather than defining what its investments are.
70. 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.
71. Credit rating information is supplied by our treasury consultants on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (potential for change in the longer term) 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.

72. 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;
 - (b) And have, as a minimum, the following Fitch, Moody's and Standard and Poors ratings (where rated):
 - i. Short Term – F1
 - ii. Long Term – A-
 - iii. Individual / Financial Strength – C (Fitch / Moody's only)
 - iv. Support – 3 (Fitch only)
 - (c) Banks 2 – Guaranteed UK Banks with suitable Sovereign Support – In addition, the Council will use UK banks whose ratings fall below the criteria specified above if all of the following conditions are met:
 - i. wholesale deposits in the bank are covered by a government guarantee;
 - ii. the Council's investments with the bank are limited to amounts and maturities within the terms of the stipulated guarantee (This would include Northern Rock)
 - (d) Banks 3 – Eligible Institutions - the organisation is an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008, with the necessary short and long term ratings required in Banks 1 above. These institutions have been subject to suitability checks before inclusion, and have access to HM Treasury liquidity if needed.
 - (e) Banks 4 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
 - (f) Building Societies– the Council will use all Societies which meet the ratings for banks outlined above. These may be eligible Institutions that have the necessary short and long term ratings
 - (g) Money Market Funds – AAA
 - (h) UK Government
 - (i) Local Authorities, Parish Councils etc
73. **Use of additional information other than credit ratings** – Additional requirements under the Code of Practice now require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, equity prices etc.) will be applied to compare the relative security of differing investment counterparties.

74. **Time and Monetary Limits applying to Investments** - The time and monetary limits for institutions on the Council's Counterparty List are as follows (these will cover both Specified and Non-Specified Investments):

Table 13

	Fitch	Moody's	Standard and Poors	Money Limit	Time limit up to
Upper limit category	AA	Aa3	AA-	£5M	3 years
Lower limit category	A-	A3	A-	£3M	1 years
Money Market Funds	AAA	Aaa	AAA	£5M	Investments can be recalled at any time
Debt Management Office				Unlimited	6 months
Own bank				£3M	1 year
Local Authorities				£5M	1 year
Guaranteed Organisations				£3M	Terms of the guarantee
Eligible Institutions				£3M	1 year

75. The proposed criteria for Specified and Non-Specified investments are shown in **Appendix 5** or approval.
76. In the normal course of the council's cash flow operations it is expected that both Specified and Non-specified investments will be utilised for the control of liquidity as both categories allow for short term investments.
77. The use of longer term instruments (greater than one year from inception to repayment) will fall in the Non-specified investment category. These instruments will only be used where the Council's liquidity requirements are safeguarded. This will also be limited by the longer term investment limits.
78. **Economic Investment Considerations** - Expectations on shorter-term interest rates, on which investment decisions are based, show likelihood of the current 0.5% Bank Rate remaining flat but with the possibility of a rise in mid-2010. The Council's investment decisions are based on comparisons between the rises priced into market rates against the Council's and advisers own forecasts.
79. There is an operational difficulty arising from the current banking crisis. There is currently little value investing longer term as the higher rated institutions which fall into the higher credit criteria do not offer good returns for longer placed investments. Therefore in the near future investment will generally be placed for up to 1 year only. This will provide better security.
80. The criteria for choosing counterparties set out above provide a sound approach to investment in "normal" market circumstances. Whilst Members are asked to approve this base criteria above, under the exceptional current market conditions the Director of Corporate Services may temporarily restrict further investment activity to those

counterparties considered of higher credit quality than the minimum criteria set out for approval. These restrictions will remain in place until the banking system returns to “normal” conditions. Similarly the time periods for investments will be restricted.

81. Examples of these restrictions would be the greater use of the Debt Management Deposit Account Facility (DMADF – a Government body which accepts local authority deposits), Money Market Funds, guaranteed deposit facilities and strongly rated institutions offered support by the UK Government.

Sensitivity to Interest Rate Movement

82. Future Council accounts will be required to disclose the impact of risks on the Council’s treasury management activity. Whilst most of the risks facing the treasury management service are addressed elsewhere in this report (credit risk, liquidity risk, market risk, maturity profile risk), the impact of interest rate risk is discussed but not quantified. The table below highlights the estimated impact of a 1% increase/decrease in all interest rates to the estimated treasury management costs/income for next year. That element of the debt and investment portfolios which are of a longer term, fixed interest rate nature will not be affected by interest rate changes.

Table 14

£M	2010/11 Estimated + 1%	2010/11 Estimated - 1%
Revenue Budgets		
Interest on Borrowing	+0.063	-0.063
Related HRA Charge	-0.034	+0.034
Net General Fund Borrowing Cost	+0.029	-0.029
Investment income	+0.200	-0.200

Treasury Management Limits on Activity

83. There are four further treasury activity limits, which were previously prudential indicators. The purpose of these are to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if these are set to be too restrictive they will impair the opportunities to reduce costs/improve performance. The indicators are:
- (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
 Upper limits on fixed interest rate exposure – Similar to the previous indicator this covers a maximum limit on fixed interest rates.

- (b) Maturity structures of borrowing – These gross limits are set to reduce the Council’s exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.
- (c) 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.

84. The Council is asked to approve the limits:

Table 15

	2010/11		2011/12		2012/13	
	Upper		Upper		Upper	
Limits on fixed interest rates	100%		100%		100%	
Limits on variable interest rates	40%		40%		40%	
Maturity Structure of fixed interest rate borrowing						
	Lower	Upper	Lower	Upper	Lower	Upper
Under 12 months	0%	25%	0%	25%	0%	25%
12 months to 2 years	0%	40%	0%	40%	0%	40%
2 years to 5 years	0%	60%	0%	60%	0%	60%
5 years to 10 years	0%	80%	0%	80%	0%	80%
10 years and above	0%	100%	0%	100%	0%	100%
Maximum principal sums invested greater than 364 days	£10M		£10M		£15M	

Performance Indicators

85. The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. Examples of performance indicators often used for the treasury function are:

- (a) Debt – Borrowing – Average overall interest rate paid compared with previous years
- (b) Investments – Short Term- cashflow investment rate returned against comparative interest rates
- (c) Investments – Longer term – capital investment rates returned against comparative average rates

86. The results of these indicators will be reported in the Treasury Management Half Yearly Review and Annual Reports for 2010/11.

Treasury Management Advisers

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

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

Member and Officer Training

89. 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:

- (a) Two training sessions were developed in Late November /Early December 2009 for all members but with a special emphasis for the Audit Committee. These outlined the processes involved in compilation of the Treasury Management Strategy. The courses were well attended by the relevant members and well received.

Outcome of Consultation

90. This report has not been consulted on but the Capital MTFP on which it is based has been the subject of wide consultation. This report has been considered by Audit Committee at its special meeting on 22nd January 2010 under their responsibilities for ensuring effective scrutiny of the treasury management and policies.

Treasury Management Clauses to form part of Financial Procedure Rules/Constitution

1. This Council will create and maintain, as the cornerstones for effective treasury management:
 - (a) A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities;
 - (b) Suitable Treasury Management Practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.
2. The Council will receive reports on its treasury management policies, practices and activities, including as a minimum, an annual strategy and plan in advance of the year, a mid year review and an annual report after its close, in the form prescribed in its TMPs.
3. The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to the Cabinet, and for the execution and administration of treasury management decisions to the Director of Corporate Services, who will act in accordance with the Council's policy statement and TMPs and CIPFA's Standard of Professional Practice on Treasury Management.
4. The organisation nominates Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

APPENDIX 2

CAPITAL EXPENDITURE AND THE SOURCES OF FINANCE						
			2009/10 Revised £m	2010/11 Estimated £m	2011/12 Estimated £m	2012/13 Estimated £m
Capital Expenditure – General Fund						
1	Supported spend		24.549	53.684	34.401	31.827
2	Unsupported spend		5.555	2.405	1.132	0.601
3	Total spend	<i>Lines 1+2</i>	30.104	56.089	35.533	32.428
Financed by:						
4	Capital receipts		0.0	1.000	0.600	0.600
5	Capital grants		20.328	48.491	32.196	29.623
6	Capital Contribution		1.620	0.702	0.0	0.0
7	Revenue		0.006	0.100	0.0	0.0
8	Total financing	<i>Lines 4 to 7</i>	21.954	50.293	32.796	30.223
9	Net financing need	<i>3 – 8</i>	8.150	5.796	2.737	2.205
Capital Expenditure - Housing Revenue Account						
10	Supported spend		7.125	5.136	4.154	4.206
11	Unsupported spend		7.330	9.053	4.226	2.141
12	Total spend	<i>10+11</i>	14.455	14.189	8.380	6.347
Financed by:						
13	Capital receipts		0.360	0.350	0.350	0.350
14	Capital grants		7.125	5.136	4.154	4.206
15	Capital Contribution		0.0	0.0	0.0	0.0
16	Revenue		2.862	1.871	2.013	1.791
17	Total financing	<i>13 to 16</i>	10.347	7.357	6.517	6.347
18	Net financing need	<i>12 – 17</i>	4.108	6.832	1.863	0.0
Capital Expenditure – Total						
19	Supported spend	<i>1+10</i>	34.902	58.820	38.555	36.034
20	Unsupported spend	<i>2+11</i>	9.657	11.458	5.358	2.742
21	Total spend	<i>19+20</i>	44.559	70.278	43.913	38.776
Financed by:						
22	Capital receipts	<i>4+13</i>	0.360	1.350	0.950	0.950
23	Capital grants	<i>5+14</i>	27.453	53.627	36.350	33.829
24	Capital Contributions	<i>6+15</i>	1.620	0.702	0.0	0.0
25	Revenue	<i>7+16</i>	2.868	1.971	2.013	1.792
26	Total financing	<i>22 to 25</i>	32.301	57.650	39.313	36.571
27	Net financing need	<i>21 – 26</i>	12.258	12.628	4.600	2.205

THE CAPITAL FINANCING REQUIREMENT					
		2009/10 Revised £m	2010/11 Estimated £m	2011/12 Estimated £m	2012/13 Estimated £m
The Capital Financing Requirement – General Fund					
28	CFR Opening Balance	74.286	79.428	81.809	81.131
29	Net financing need	9	8.150	5.796	2.205
30	Less MRP & VRP		3.008	3.415	3.858
31	CFR Closing balance	28 to 30	79.428	81.809	79.478
32	Net movement in CFR	31-28	5.142	2.381	-1653
The Capital Financing Requirement IFRS PFI Etc					
33	CFR Opening Balance		28.056	26.479	23.434
34	Net financing need		0.0		
35	Less MRP & VRP		1.577	1.540	1.472
36	CFR Closing balance		26.479	24.939	21.962
37	Net movement in CFR		-1.577	-1.540	-1.472
The Capital Financing Requirement - HRA					
38	CFR Opening Balance		30.800	34.638	42.135
39	Net financing need	18	4.108	6.832	0.0
40	Less MRP & V RP		0.270	0.579	0.666
41	CFR Closing balance	33 to 35	34.638	40.891	41.469
42	Net movement in CFR	36-33	3.838	6.253	-0.666
The Capital Financing Requirement - Total					
43	CFR Opening Balance	28+33+38	133.142	140.545	146.700
44	Net financing need	29+34+39	12.258	12.628	2.205
45	MRP & VRP	30+35+40	4.855	5.534	5.996
46	CFR Closing balance	43+44-45	140.545	147.639	142.909
47	Net movement in CFR	46-43	7.403	7.094	-3.791

BUTLERS VIEW OF UK AND WORLD ECONOMY AND ITS EFFECT ON UK INTEREST RATES

1. Short-term rates are expected to remain on hold for a considerable time. The recovery in the economy has commenced but it will remain insipid and there is a danger that early reversal of monetary ease, (rate cuts and Quantitative Easing {QE}), could trigger a dip back to negative growth and a W-shaped GDP path.
2. Credit extension to the corporate and personal sectors has improved modestly but banks remain nervous about the viability of counterparties. This is likely to remain a drag upon activity prospects, as will the lacklustre growth of broad money supply.
3. The main drag upon the economy is expected to be weak consumers' expenditure growth. The combination of the desire to reduce the level of personal debt and job uncertainty is likely to weigh heavily upon spending. This will be amplified by the prospective increases in taxation already scheduled for 2010 – VAT and National Insurance. Without a rebound in this key element of UK GDP growth, any recovery in the economy is set to be weak and protracted.
4. The MPC will continue to promote easy credit conditions via QE. QE has been extended to a total of £200bn and there is still an outside chance that it could be expanded further next February. Whether this has much impact in the near term remains a moot point given the personal sector's reluctance to take on more debt and add to its already unhealthy balance sheet.
5. With inflation set to remain subdued in the next few years, the pressure upon the MPC to hike rates will remain moderate. But some increase will be seen as necessary in 2010 to counter the effects of external cost pressures (as commodity prices begin to rise again) and to avoid damage that sterling could endure if the UK is seen to defy an international move to commence policy exit strategies.
6. Longer term rates are expected to be more volatile. The current 'softness' of gilt yields & PWLB rates may continue for a while yet, given that these are being driven by a benign international backdrop and the effects of QE. Nevertheless this process will come to an end before the close of the financial year.
7. This is likely to herald a return to rising yields for a number of reasons:
 - (a) Net gilt issuance will rise sharply;
 - (b) This will be increased by the extent to which the BoE attempts to claw back funds injected to the economy via the QE programme;
 - (c) Investors will be looking to place more of their funds in alternative instruments as their risk appetite increases, demand for gilts will weaken as a consequence;
 - (d) A decision to leave QE in place will generate inflation concerns and pressurise long yields higher.The market/BoE is in a lose/lose situation.

Security, Liquidity and Yield Benchmarking

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

2. A proposed development for Member reporting is the consideration and approval of security and liquidity benchmarks.
3. 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.
4. Yield – These benchmarks are currently widely used to assess investment performance. 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
5. Security and liquidity benchmarks are already intrinsic to the approved treasury strategy through the counterparty selection criteria and some of the prudential indicators. However they have not previously been separately and explicitly set out for Member consideration. Proposed benchmarks for the cash type investments are below and these will form the basis of future reporting in this area. In the other investment categories appropriate benchmarks will be used where available.
6. Liquidity – This is defined as “having adequate, though not excessive cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives” (CIPFA Treasury Management Code of Practice). In respect of this area the Council seeks to maintain:
 - (a) Bank overdraft - £0.500M
 - (b) Liquid short term deposits of at least £3M available with a week’s notice.
7. The availability of liquidity and the term risk in the portfolio can be benchmarked by the monitoring of the Weighted Average Life (WAL) of the portfolio – shorter WAL would generally embody less risk. In this respect the proposed benchmark is to be used:

WAL benchmark is expected to be 0.5 years, with a maximum of 1.25 years.

8. Security of the investments – In context of benchmarking, assessing security is a much more subjective area to assess. Security is currently evidenced by the application of minimum credit quality criteria to investment counterparties, primarily through the use of credit ratings supplied by the three main credit rating agencies (Fitch, Moody’s and Standard and Poors). Whilst this approach embodies security considerations, benchmarking levels of risk is more problematic. One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council’s investment strategy. The table beneath shows average defaults for differing periods of investment grade products for each Fitch long term rating category over the period 1990 to 2007.

Long term rating	1 year	2 years	3 years	4 years	5 years
AAA	0.00%	0.00%	0.00%	0.00%	0.00%
AA	0.00%	0.00%	0.00%	0.03%	0.06%
A	0.03%	0.15%	0.30%	0.44%	0.65%
BBB	0.24%	0.78%	1.48%	2.24%	3.11%

9. The Council's minimum long term rating criteria is currently "A-", meaning the average expectation of default for a one year investment in a counterparty with a "A-" long term rating would be 0.03% of the total investment (e.g. for a £1m investment the average loss would be £300). This is only an average - any specific counterparty loss is likely to be higher - but these figures do act as a proxy benchmark for risk across the portfolio.
10. The Council's maximum security risk benchmark for the whole portfolio, when compared to these historic default tables, is:

0.03% historic risk of default when compared to the whole portfolio.

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

	1 year	2 years	3 years
Maximum	0.03%	0.15%	0.00%

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.

Treasury Management Practice (TMP) 1 (5) – 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. The CLG is currently consulting over revisions to the Guidance and where applicable the Consultation recommendations have been included within this policy. These guidelines do not apply to either trust funds or pension funds which are under a different regulatory regime.
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 Finance 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 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.
4. The investment policy proposed for the Council is:

Strategy Guidelines –

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

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

Non-Specified Investments –

8. Non-specified investments are any other type of investment (i.e. not defined as Specified above).

	Non Specified Investment Category	Limit (£ or %)
a.	Eligible Institutions - the organisation is an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008, with the necessary short and long term ratings required in Banks 1 above (see Paragraph 71 in main report) These institutions have been subject to suitability checks before inclusion, and have access to HM Treasury liquidity if needed.	50%
b.	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
c.	Any bank or building society that has a minimum long term credit rating of AA-, for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	£10M

9. The table below shows the minimum credit rating for inclusion on the Council counterparty list

Table 1

Type	Fitch				Moody's		
	Short Term	Long Term	Ind.	Support	Short Term	Long Term	Financial Strength
UK Bank	F1	A-	C	3			
MMF	AAA				AAA		
DMADF	-				-		
UK Building Society (1)					P-1	A3	C
Eligible Institutions	F1	A-	-		P-1-	A3-	-
Guaranteed Organisations							

10. Table 2 shows investment time and money limits categorised between specified and non specified investments

Table 2

Type	Fitch				Moody's			Time Limit	Money limit
	Short Term	Long Term	Ind	Support	Short Term	Long Term	Financial Strength		
UKBank / Building Society	F1	A-	-	-	P-1			1 year	£5m
MMF	AAA							Call	£5m
DMADF	-				-			6 months	Unlimited
Guaranteed Organisations								Term of Guarantee	£3m
Eligible Institutions								1 year	£3m
Long term UK Bank / BS	F1	AA-	C	3	P-1	A3	C	3 years	£5m

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 Butlers as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Director of Corporate Services, and if required new counterparties which meet the criteria will be added to the list.