AGENDA ITEM NO 9

2013/14 ANNUAL TREASURY MANAGEMENT STRATEGY, MINIMUM REVENUE PROVISION POLICY STATEMENT AND ANNUAL INVESTMENT STRATEGY

Committee: Finance and Governance Committee

Date: 31 January 2013

Author: Senior Accountancy Assistant

[M222]

1.0 ISSUE

1.1 To consider the 2013/14 Treasury Management Strategy, the Annual Investment Strategy and the Minimum Revenue Provision Policy Statement.

1.2 These strategies and statements will be presented to Full Council for approval on 21 February 2013.

2.0 RECOMMENDATIONS

2.1 That Finance and Governance Committee recommends to Full Council to approve:

- The 2013/14 Treasury Management Strategy
- The Annual Investment Strategy
- The Minimum Revenue Provision Policy Statement
- The Prudential and Treasury Indicators.

3.0 BACKGROUND/ OPTIONS

3.1 CIPFA Requirements

The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice on Treasury Management (revised November 2009) was adopted by the Council on 23 February 2010. The Code was revised in 2011, with minor changes, and Full Council will be recommended to adopt the revised 2011 Code on 21 February 2013.

3.2 The Treasury Management Policy Statement

As per CIPFA's definition, the Council defines its treasury management activities as:

- The management of the Council'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.

- The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Council, and any financial instruments entered into to manage these risks.
- The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

3.3 Clauses to be formally adopted

The Council will create and maintain, as the cornerstones for effective treasury management:

- a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities

- suitable treasury management practices (TMPs), setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities

.

The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of this Council. Such amendments will not result in the Council materially deviating from the Code's key principles.

- Full 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.

- The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Finance and Governance Committee, and for the execution and administration of treasury management decisions to the Head of Finance, who will act in accordance with the

Council's policy statement and TMPs and, if a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

- The Council nominates Finance and Governance Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

3.4 Background

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.

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.

3.5 Reporting Requirements

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals.

Prudential and Treasury Indicators and Treasury Strategy (This report) - The first, and most important, report covers:

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

A Mid Year Treasury Management Report – This will update Members with the progress of the capital position, amending prudential

indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision.

An Annual Treasury Report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny

The above reports are required to be adequately scrutinised by committee before being recommended to Full Council. This role is undertaken by the Finance and Governance Committee.

3.6 Treasury Management Strategy for 2013/14

The strategy for 2013/14 covers two main areas:

Capital Issues

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

Treasury management Issues

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

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

Please see attached appendices for details.

3.7 Training

The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in treasury management. This especially applies to Members responsible for scrutiny. Treasury management training has

been undertaken by Members on 12 January 2012 and further training will be arranged as required.

The training needs of treasury management officers are periodically reviewed.

3.8 Treasury management consultants

The Council uses Sector as its external treasury management advisors.

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

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.

4. 0 ARGUMENT/CONCLUSIONS

4.1 The annual submission of the Treasury Management Strategy Statement, the Annual Investment Strategy and the Minimum Revenue Provision Policy Statement to Full Council (via Finance and Governance Committee) is a requirement of the CIPFA Treasury Management Code of Practice.

4.2 The Strategies set out the parameters for the operation of the Treasury Management and Investment function over the next three years. In practical terms, it sets out the Council's policy concerning all money market investment and borrowing.

4.3 The strategy therefore envisages that **business reserve accounts** will be used significantly while they continue to offer beneficial above market rates.

However one bank has recently reduced its rates for its 35 day notice account from 0.8% to 0.4% and it will reduce further to 0.3% from 19th February (2013).
The remaining banks may well reduce their rates in due course.

Any other investments will be short-term with highly rated counterparties. Borrowing will be short-term for cash flow purposes if required.

The Head of Finance will keep this under review, especially if there are any changes in circumstances, and report to Finance and Governance Committee /Full Council if required.

4.4 Investments had been temporarily restricted to 3 months on Sector's advice due to the Euro zone issues, except for UK government supported organisations which remained as a maximum 1-year duration (blue rating).

On 11 January 2013, Sector recommended that this restriction should be removed, advising that market conditions are such that the need for a more stringent limit on duration is no longer necessary. Although this change is by no means suggesting that problems within financial markets are fully resolved, it is a reflection that some of the excess fears surrounding the continued existence of the Eurozone have subsided and that liquidity in financial markets is now significantly improved.

4.5 **From 2013/14** the 3 month LIBID (London Inter-Bank Bid Rate) will be used as a **benchmark** for the Council's investments replacing the 1 month LIBID. As an element of its investment portfolio is invested for longer than a month, the 1 month LIBID usually leads to outperformance.

The 3 month LIBID will be more reflective of an investment portfolio which should have a mixture of funds held in call accounts for liquidity purposes, with some surplus cash locked away for longer periods.

Due to the current market uncertainties, there is virtually no difference between the rates, however longer-term the use of the 3 month benchmark is more suitable.

4.6 Appendix 7 shows details of current 2012/13 investments as at 31December 2012.

5.0 FINANCIAL IMPLICATIONS

5.1 The costs of managing the treasury activity and the income generated from it are reflected in the proposed budgets reported separately to this Committee. The investment interest budget for 2013/14 is £140,000.

6.0 APPENDICES

6.1 Appendix 1 – The Capital Prudential Indicators, Borrowing and Annual Investment Strategy
Appendix 2 – Interest rate forecasts
Appendix 3 – Treasury Management Practice - Specified and Non-specified investments and limits
Appendix 4 – Approved countries for investments
Appendix 5 – Treasury management scheme of delegation
Appendix 6 – The treasury management role of the section 151 officer
Appendix 7 – Investments Outstanding as at 31 December 2012

Background Documents	**Location**	**Contact Officer**
The Prudential Code published by CIPFA	Room 204 The Grange Ely	Ann Hughes Senior Accountancy Assistant (01353) 616270 E-mail: ann.hughes@eastcambs.gov.uk
Treasury Management Practice Schedules		
Capital Programme		
Strategic Policy & Resources Committee 26 January 2012		
Loans Register		
Budget book and Financial Management System		

Appendix 1

1 THE CAPITAL PRUDENTIAL INDICATORS 2013/14 – 2015/16

1.1 Capital expenditure

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

Capital expenditure £000	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Total	**1,289**	**1,593**	**4,238**	**608**	**608**

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

Capital expenditure £000	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Total	**1,289**	**1,593**	**4,238**	**608**	**608**
Financed by:					
Capital receipts	359	254	8	7	6
Capital grants	668	672	3,830	200	200
Capital reserves	257	496	371	372	373
Revenue	5	171	29	29	29
Net financing need for the year	**0**	**0**	**0**	**0**	**0**

1.2 The Council's borrowing need (the Capital Financing Requirement)

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.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes.

The Council currently has £270,000 of such schemes within the CFR, due to the embedded leases for the refuse and recycling vehicles. It does not affect the Council's underlying need to borrow and the Council has no external borrowing.

The Council is asked to approve the CFR projections below:

£000	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Capital Financing Requirement					
Total CFR	**250**	**119**	**4**	**(110)**	**(140)**
Movement in CFR	**(122)**	**(131)**	**(114)**	**(114)**	**(30)**

Movement in CFR represented by					
Net financing need for the year (above)	**0**	**0**	**0**	**0**	**0**
Less MRP/VRP and other financing movements	**(122)**	**(131)**	**(114)**	**(114)**	**(30)**
Movement in CFR	**(122)**	**(131)**	**(114)**	**(114)**	**(30)**

The MRP will include finance lease annual principal payments.

(VRP - voluntary revenue provision)

The CFR shows the write-down of the **existing** refuse vehicles. No assumption has been made regarding the replacement of these vehicles when the recycling and organics collection services change to wheeled bins.

1.3 Minimum revenue provision (MRP) policy statement

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

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

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

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3).

This option provides for a reduction in the borrowing need over approximately the asset's life.

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

1.4 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.).

1.5 Affordability prudential indicators

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:

1.6 Ratio of financing costs to net revenue stream.

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

	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
%	(2.75)	(2.59)	(2.95)	(3.06)	(2.90)

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

1.7 Incremental impact of capital investment decisions on council tax.

This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

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

£	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Council tax - band D	4.44	10.21*	5.23	5.18	2.21**

*Due to increased revenue contributions for Reception Refurbishment and Vehicle Replacements. Latter includes budgets carried forward from previous years as purchasing delayed and leasing options investigated, and it is likely to be carried forward to 2013/14.

** Decrease in MRP as existing refuse vehicles near the end of their asset life.

2 BORROWING

The capital expenditure plans set out in Section 1 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.

2.1 Current portfolio position

The Council's treasury portfolio position at 31 March 2012, 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.

£000	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
External Debt					
Debt at 1 April	0	0	0	0	0
Expected change in Debt	0	0	0	0	0
Other long-term liabilities (OLTL)	512	390	259	144	30
Expected change in OLTL	122	131	115	114	30
Actual gross debt at 31 March	**390**	**259**	**144**	**30**	**0**
The Capital Financing Requirement	**250**	**119**	**4**	**(110)**	**(140)**
Under / (over) borrowing	**140**	**140**	**140**	**140**	**140**

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 gross debt 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 2013/14 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Head of Finance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes

into account current commitments, existing plans, and the proposals in this budget report.

2.2 Treasury Indicators: limits to borrowing activity

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

Operational boundary £000	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Debt	0	0	0	0
Other long term liabilities	390	259	144	30
Total	390	259	144	30

The authorised limit for external debt. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by Full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
2. The Council is asked to approve the following authorised limit:

Authorised limit £000	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Debt	4,610	4,741	4,856	4,970
Other long term liabilities	390	259	144	30
Total	5,000	5,000	5,000	5,000

2.3 Prospects for interest rates

A more detailed interest rate view is at appendix 2.

The Council has appointed Sector as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the Sector central view.

The forecast incorporates the **PWLB certainty rate**, which reduces PWLB borrowing rates by 0.20% for most local authorities. However this reduction does not apply to this Council as long-term borrowing was not required for its capital spending plans.

Annual Average %	Bank Rate	PWLB Borrowing Rates (including certainty rate adjustment)		
		5 year	25 year	50 year
Dec 2012	0.50	1.50	3.70	3.90
March 2013	0.50	1.50	3.80	4.00
June 2013	0.50	1.50	3.80	4.00
Sept 2013	0.50	1.60	3.80	4.00
Dec 2013	0.50	1.60	3.80	4.00
March 2014	0.50	1.70	3.90	4.10
June 2014	0.50	1.70	3.90	4.10
Sept 2014	0.50	1.80	4.00	4.20
Dec 2014	0.50	2.00	4.10	4.30
March 2015	0.75	2.20	4.30	4.50
June 2015	1.00	2.30	4.40	4.60
Sept 2015	1.25	2.50	4.60	4.80
Dec 2015	1.50	2.70	4.80	5.00
March 2016	1.75	2.90	5.00	5.20

The economic recovery in the UK since 2008 has been the worst and slowest recovery in recent history, although the economy returned to positive growth in the third quarter of 2012.

Growth prospects are weak and consumer spending, the usual driving force of recovery, is likely to remain under pressure due to consumers focusing on repayment of personal debt, inflation eroding disposable income, general malaise about the economy and employment fears.

The primary drivers of the UK economy are likely to remain external. 40% of UK exports go to the Eurozone so the difficulties in this area are likely to continue to hinder UK growth.

The US, the main world economy, faces similar debt problems to the UK, but urgently needs to resolve the fiscal cliff now that the the Presidential elections are out of the way. The resulting US fiscal tightening and continuing Eurozone problems will depress UK growth and is likely to see the UK deficit reduction plans slip.

This challenging and uncertain economic outlook has several key treasury mangement implications:

- Investment returns are likely to remain relatively low during 2013/14 and beyond;
- The Eurozone sovereign debt difficulties provide a clear indication of high counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Borrowing interest rates continue to be attractive and may remain relatively low for some time. The timing of any borrowing will need to be monitored carefully;

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

2.4 Borrowing strategy

As the Council has no external borrowing and the current capital programme does not require borrowing for funding, it is anticipated that no long term borrowing will be undertaken. Only short term borrowing will be undertaken if required for cash flow purposes.

However this strategy will be applied if required.

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

Against this background and the risks within the economic forecast, caution will be adopted with the 2013/14 treasury operations. The Head of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- 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.

- 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.

Any decisions will be reported to the appropriate committee at the next available opportunity.

Treasury management limits on activity

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

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

- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

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

£m	2013/14	2014/15	2015/16
Interest rate exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	25	25	25
Limits on variable interest rates based on net debt	25	25	25
Maturity structure of fixed interest rate borrowing 2013/14			
		Lower	**Upper**
Under 12 months		0%	100%
12 months to 2 years		0%	100%
2 years to 5 years		0%	100%
5 years to 10 years		0%	100%
10 years and above		0%	100%
Maturity structure of variable interest rate borrowing 2013/14			
		Lower	**Upper**
Under 12 months		0%	100%
12 months to 2 years		0%	100%
2 years to 5 years		0%	100%
5 years to 10 years		0%	100%
10 years and above		0%	100%

2.5 Policy on borrowing in advance of need

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.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3 ANNUAL INVESTMENT STRATEGY

3.1 Investment policy

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 and then **return**.

In accordance with guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list.

The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies, with a full understanding of what these reflect in the eyes of each agency.

Using the Sector ratings service, potential counterparty ratings are monitored on a real time basis, with knowledge of any changes notified electronically as the agencies notify modifications.

Furthermore, 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" (CDS's) and overlay that information on top of the credit ratings.

This is fully integrated into the credit methodology provided by the advisors Sector in producing its colour codings, which show the varying degrees of suggested creditworthiness.

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.

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

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

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.

3.2 Creditworthiness policy

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

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

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

- Yellow 5 years *
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No colour Not to be used

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

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

Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of short term rating F1, long term rating A-, viability rating of A-, and a support rating of 1.

There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored **weekly** and as notifications are received. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

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

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

3.3 Country limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA+ from Fitch or equivalent. This will ensure that if the UK's rating of AAA is downgraded by one, or more, rating agencies, the Council will continue to able to invest in UK banks and the UK government.

The list of countries that qualify using this credit criteria, as at the date of this report, are shown in Appendix 4. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

Sector's view is that all councils should avoid a concentration of investments in too few counterparties or countries, but that a suitable spreading approach in itself is likely to be sufficient, given the safeguards already built into its creditworthiness service. Investment portfolios vary considerably in size and any policy needs to be workable.

AAA rating. The UK continues to enjoy an AAA sovereign rating. However, the credit rating agencies will be carefully monitoring the rate of growth in the economy as a disappointing performance in that area could lead to a major derailment of the plans to contain the growth in the total amount of Government debt over the next few years.

3.4 Investment strategy

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

Investment returns expectations. Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 4 of 2014. Bank Rate forecasts for financial year ends (March) are:

- 2012/13 0.50%
- 2013/14 0.50%

- 2014/15 0.75%
- 2015/16 1.75%

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.

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

2013/14	0.50%
2014/15	0.60%
2015/16	1.50%
2016/17	2.25%

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

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

Maximum principal sums invested > 364 days			
	2013/14	**2014/15**	**2015/16**
Principal sums invested > 364 days	£2m	£2m	£2m

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

3.5 End of year investment report

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

Interest Rate Forecasts 2013 – 2016 **APPENDIX 2**

Sector's Interest Rate View	Now	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Sector's Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%
3 Month LIBID	0.40%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.60%	0.60%	0.70%	0.80%	1.10%	1.40%	1.70%	1.90%
6 Month LIBID	0.56%	0.70%	0.70%	0.70%	0.70%	0.70%	0.70%	0.80%	0.90%	1.00%	1.10%	1.30%	1.60%	1.90%	2.20%
12 Month LIBID	0.92%	1.00%	1.00%	1.00%	1.00%	1.00%	1.10%	1.10%	1.20%	1.30%	1.30%	1.50%	1.80%	2.10%	2.40%
5yr PW LB Rate	1.66%	1.50%	1.50%	1.50%	1.60%	1.60%	1.70%	1.70%	1.80%	2.00%	2.20%	2.30%	2.50%	2.70%	2.90%
10yr PW LB Rate	2.64%	2.50%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	3.00%	3.20%	3.30%	3.50%	3.70%	3.90%
25yr PW LB Rate	3.88%	3.70%	3.80%	3.80%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.30%	4.40%	4.60%	4.80%	5.00%
50yr PW LB Rate	4.04%	3.90%	4.00%	4.00%	4.00%	4.00%	4.10%	4.10%	4.20%	4.30%	4.50%	4.60%	4.80%	5.00%	5.20%
Bank Rate															
Sector's View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%
UBS	0.50%	0.50%	0.50%	0.50%	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 PW LB Rate															
Sector's View	1.66%	1.50%	1.50%	1.50%	1.60%	1.60%	1.70%	1.70%	1.80%	2.00%	2.20%	2.30%	2.50%	2.70%	2.90%
UBS	1.66%	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital Economics	1.66%	1.30%	1.30%	1.30%	1.30%	1.30%	1.30%	1.30%	1.50%	1.60%	-	-	-	-	-
10yr PW LB Rate															
Sector's View	2.64%	2.50%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	3.00%	3.20%	3.30%	3.50%	3.70%	3.90%
UBS	2.64%	2.80%	3.00%	3.10%	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	-	-	-	-	-
Capital Economics	2.64%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	-	-	-	-	-
25yr PW LB Rate															
Sector's View	3.88%	3.70%	3.80%	3.80%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.30%	4.40%	4.60%	4.80%	5.00%
UBS	3.88%	4.00%	4.20%	4.30%	4.40%	4.50%	4.50%	4.50%	4.50%	4.50%	-	-	-	-	-
Capital Economics	3.88%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	-	-	-	-	-
50yr PW LB Rate															
Sector's View	4.04%	3.90%	4.00%	4.00%	4.00%	4.00%	4.10%	4.10%	4.20%	4.30%	4.50%	4.60%	4.80%	5.00%	5.20%
UBS	4.04%	4.10%	4.30%	4.40%	4.50%	4.60%	4.60%	4.60%	4.60%	4.60%	-	-	-	-	-
Capital Economics	4.04%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	-	-	-	-	-

APPENDIX 3: Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

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

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the specified investment criteria. A maximum of 75% will be held in aggregate in non-specified investment.

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

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

	Minimum credit criteria / colour band	**Max. % of total investments/ £ limit per institution**	**Maximum maturity period ****
DMADF – UK Government	N/A	100%	6 months
Money market funds	AAA	100%	Liquid
Local authorities (LA's)	N/A	100% / £3m per LA	Unlimited
Term deposits with banks and building societies	Yellow Purple * Blue Orange * Red * Green * No Colour	£3m £3m £3m £3m £3m £3m 0	Up to 5 years Up to 2 years Up to 1 year Up to 1 year Up to 6 Months Up to 3 months Not for use

* Most investments were temporarily restricted to 3 months on Sector's advice due to the Eurozone issues; however the advice is now to remove this restriction.

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

The criteria in this appendix are intended to be the operational criteria in normal times. At times of heightened volatility, risk and concern in financial markets, this

strategy may be amended by temporary operational criteria, further limiting investments to counterparties of a higher creditworthiness and / or restricted time limits.

SPECIFIED INVESTMENTS:
(All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' rating criteria where applicable)

	Minimum 'High' Credit Criteria	**Use**
Debt Management Agency Deposit Facility	--	In-house
Term deposits – local authorities	--	In-house
Term deposits – banks and building societies	Green	In-house

Term deposits with nationalised banks and banks and building societies

	Minimum Credit Criteria	**Use**	**Max % of total investments**	**Max. maturity period**
UK part nationalised banks	Blue	In-house	100	1 year
Banks part nationalised by high credit rated (sovereign rating) countries – non UK**	Sovereign rating or Short-term F1, Long-term A-, Viability bb+, Support 3, Sovereign rating AA+	In-house	75	2 years

If the Council uses a subsidiary of a parent bank and the subsidiary does not have a credit rating in its own right, then an unconditional guarantee from the parent would be required.

See approved list of countries at appendix 4.

Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): -		
1. Money Market Funds	Long-term AAA mmf volatility rating MR1+	In-house

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

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by the Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, officers will review the accounting implications of new transactions before they are undertaken.

NON-SPECIFIED INVESTMENTS: A maximum of 75% will be held in aggregate in non-specified investment.

1. Maturities of ANY period

	Minimum Credit Criteria	**Use**	**Max. % of total investments**	**Max. maturity period**
Other debt issuance by UK banks covered by UK Government (explicit) guarantee	UK sovereign rating or Short-term F1, Long-term A-, Viability C, Support 3	In-house	75	2 years

2. Maturities in excess of 1 year

	Minimum Credit Criteria	**Use**	**Max % of total investments**	**Max. maturity period**
Term deposits – local authorities	--	In-house	75	Unlimited
Term deposits – banks and building societies	Purple	In-house	75	2 years

If the Council uses a subsidiary of a parent bank and the subsidiary does not have a credit rating in its own right, then an unconditional guarantee from the parent would be required.

APPENDIX 4: Approved countries for investments

Based on lowest available rating

AAA

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

AA+

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

APPENDIX 5: Treasury management scheme of delegation

(i) Full Council

- approval of annual strategy
- approval of/amendments to the organisation's adopted clauses and treasury management policy statement
- budget approval
- approval of the division of responsibilities.

(ii) Finance and Governance Committee

- receiving and reviewing reports on treasury management policies, practices and activities
- budget consideration
- receiving and reviewing regular monitoring reports and acting on recommendations.

(iii) Head of Finance

- reviewing the treasury management policy and procedures and making recommendations to Finance and Governance Committee/Full Council
- approving the selection of external service providers and agreeing terms of appointment.

APPENDIX 6: The treasury management role of the section 151 officer

The S151 (Responsible) Officer (Head of Finance)

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

CURRENT INVESTMENT LOANS OUTSTANDING AS AT 31 DECEMBER 2012 **Appendix 7**

NAME		AMOUNT	INVESTED	EXPIRES	CREDIT RATING:				NOTES	RATES	
		£000								%	
					WHEN INVESTED		CURRENT		SOVEREIGN		
					Colour	Duration	Colour	Duration			
INVESTMENTS (Fixed Term Deposits):									1, 2		
Birmingham City Council		1,000	01-Nov-12	05-Feb-13	Yellow	5 years	Yellow	5 years	AAA	0.30	
Greater Manchester Police Authority		2,000	15-Nov-12	05-Feb-13	Yellow	5 years	Yellow	5 years	AAA	0.27	
Lloyds Bank of Scotland		1,000	12-Apr-12	11-Apr-13	Blue	1 year	Blue	1 year	AAA	3.00	
Lloyds Bank of Scotland		1,000	30-Oct-12	30-Oct-13	Blue	1 year	Blue	1 year	AAA	2.25	
Nationwide		1,000	31-Oct-12	25-Jan-13	Green	3 months	Green	3 months	AAA	0.40	
RBS		1,500	29-Nov-12	27-Nov-13	Blue	1 year	Blue	1 year	AAA	1.58	
DMO (Government)		450	18-Dec-12	02-Jan-13	Yellow	5 years	Yellow	5 years	AAA	0.25	
CALL ACCOUNTS (Instant Access / Notice Deposit Accounts):									3		
Barclays Bank Plc	Instant	2,999	06-Dec-12		Green	3 months	Green	3 months	AAA	0.15	+0.4% at y/e
(Svenska) Handelsbanken	Instant	50	31-Dec-12		Green	3 months	Green	3 months	AAA	0.25	
(Svenska) Handelsbanken	35 day	2,100	17-Dec-12		Green	3 months	Green	3 months	AAA	0.40	
Lloyds Bank of Scotland	Instant	1,000	10-Dec-12		Blue	1 year	Blue	1 year	AAA	0.75	
RBS	Instant	1,499	31-Dec-12		Blue	1 year	Blue	1 year	AAA	0.80	B.R.+ 0.30
	TOTAL	**15,598**									

KEY:

y/e - year end

B.R. - Base Rate

NOTES:

1. Due to the Eurozone issues, from 8 September 2011 all counterparties on Sector's list temporarily had their ratings reduced to green (3 months). This restriction is removed from January 2013. This excluded UK government supported organisations, which remained as a maximum 1 year duration (blue rating) and Local Authorities and UK Government which remained a 5 year duration (yellow rating).

2. At least £1m of the £3m maximum total invested with any one counterparty or group of counterparties will be callable or to be repaid within 1 month.

3. The amount held in these accounts fluctuates as they are used for small surpluses.