

**DRAFT TREASURY MANAGEMENT STRATEGY 2011/12 - 2013/14 &
ANNUAL INVESTMENT STRATEGY 2011/12 &
MINIMUM REVENUE PROVISION STATEMENT 2011/12**

EXECUTIVE MEMBER: Cllr Elaine Woodburn, Leader of the Council
LEAD OFFICER: Joanne Wagstaffe, Corporate Director for Resources and Transformation
REPORT AUTHORS: Ann Treble, Capital & Project Accountant & Leanne Barwise, Senior Accounting Officer

WHY HAS THIS REPORT COME TO THE EXECUTIVE?

This report has come to Executive to obtain a Policy recommendation for Full Council.

This report sets out the proposed Treasury Management Statement; its Investment Strategy and Minimum Revenue Provision Strategy for 2011/12 and consequently, fulfils four key legislative requirements (recommended below) concerning the expected treasury operations of the Council, setting the framework for the Council's borrowing and investment activities and the funding of the Capital Programme.

It should be noted that these strategies cannot be fully completed until the Capital Programme for 2011/12 is finalised and they are issued in draft for consultation purposes. Please note that the format of this draft report may be amended before the final version is submitted and considered; firstly by Audit Committee on 4th February 2011, then onto Executive on 9th February 2011 and to be recommended to Full Council on 22nd February 2011.

RECOMMENDATION:

The Executive is recommended to approve each of the key elements of the below named reports, and recommend the same to Council:

1. The Prudential Indicators and Limits for 2011/12 to 2013/14 contained within Appendix A of the report, including the Authorised Limit Prudential Indicator.
2. The Minimum Revenue Provision (MRP) Statement contained within Appendix A which sets out the Council's policy on MRP.
3. The Treasury Management Strategy 2011/12 to 2013/14, and the treasury Prudential Indicators contained within Appendix B.
4. The Investment Strategy 2011/12 contained in the treasury management strategy (Appendix B), and the detailed criteria included in Annex B1.

1. INTRODUCTION

- 1.1 The Council's Financial Regulations require the Treasury Management Strategy to be reported to Council on an annual basis. This report complies with this requirement. It also sets the framework against which the Treasury

Management activity of the Council will be evaluated against and the basis of the mid-year performance report and year end outturn report for 2011/12.

- 1.2 In agreeing this report for recommendation to approval by Council when it considers the Council's Budget 2011/12, Executive will be demonstrating the Council's compliance with legislative requirements under the Local Government Act 2003, concerning the CIPFA Prudential Code for Capital Finance in Local Authorities.
 - 1.3 The Local Government Act 2003 introduced a new borrowing system for local authorities known as the Prudential Code (the Code). The Code began on 1st April 2004 and it gives Councils much greater freedom and flexibility to borrow without government consent so long as they can afford to repay the amount borrowed.
 - 1.4 The aim of the Code is to support local authorities when making capital investment decisions. These decisions should also be in line with the objectives and priorities as set out in the Council's Corporate Plan.
 - 1.5 The key objectives of the Code are to ensure, within a clear framework, that the capital investment plans of the Council are affordable, prudent and sustainable, or if appropriate to demonstrate that they may not be. The Code requires reporting procedures to be implemented to monitor the progress and status of the capital expenditure plans. The Council's capital expenditure plans are set out in the Capital Programme, and the proposed Capital Programme 2011/12 – 2013/14 is set out elsewhere on the agenda for consideration.
 - 1.6 A further key objective is to ensure that treasury management decisions are taken in accordance with good professional practice and in a manner that supports prudence, affordability and sustainability. These objectives are consistent with and support local strategic planning, local asset management planning and proper option appraisal. They also encourage sound treasury management decisions.
 - 1.7 The Capital Prudential Indicators set out in Appendix A demonstrate that Council is fulfilling these objectives. It is for the Council itself to set any indicative limits or ratios. It is also important to note that the indicators are not designed to be comparative performance figures indicators but to support and record the Council's decision making process. The prudential indicators are included in this strategy, covering the period 2011/12 – 2013/14 and are set out in Appendix A.
 - 1.8 These strategies have been written in consultation with our Treasury Management Advisors, Sector.
- 2. DETAIL – TREASURY MANAGEMENT STRATEGY STATEMENT, INVESTMENT STRATEGY AND MRP STRATEGY 2011/12**
- 2.1 This report outlines the Council's prudential indicators for 2011/12 – 2013/14 and sets out the expected treasury operations for this period. It provides an approved framework within which the officers undertake the day to day capital and treasury activities fulfilling four key legislative requirements:

- The reporting of the **prudential indicators**, setting out the expected capital activities (as required by the CIPFA Prudential Code for Capital Finance in Local Authorities - Appendix A). The treasury management prudential indicators are now included as treasury indicators in the CIPFA Treasury Management Code of Practice;
 - The Council's **Minimum Revenue Provision (MRP) Policy**, which sets out how the Council will pay for capital assets through revenue each year (as required by Regulation under the Local Government and Public Involvement in Health Act 2007 – Also Appendix A);
 - 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. 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. This is the Affordable Borrowing Limit required by s3 of the Local Government Act 2003. This is in accordance with the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code and shown at Appendix B;
 - The **Investment Strategy** which sets out the Council's criteria for choosing investment counterparties and limiting exposure to the risk of loss. This strategy is in accordance with the CLG Investment Guidance. And also shown in Appendix B.
- 2.2 For the remaining months of the 2010/11 financial year, shorter-term interest rates, on which investment decisions are based, are likely to remain subdued for some time. This together with a combination of counterparty risk and lack of value in longer term deposit rates, we are likely to see the continuation of an investment policy of maintaining shorter term, high quality investments.
- 2.3 Forecasts expect rates to begin rising over the course of 2011/12. It is currently difficult to have confidence as to exactly how strong the UK economic recovery is likely to be. There are huge uncertainties in all forecasts. Counterparty risk should become more subdued and with the expectation of an increasing Bank Rate, value will begin to return to longer term investments. If there is clear evidence of this taking place, an amendment to the investment strategy to cautiously extend investments may be considered.
- 2.4 Members will note that the Investment Strategy (Appendix B, Paragraph 51) includes the option to lend on a short term basis to the local building societies of the Cumberland and Furness Building Societies. These institutions would normally fall below the Council's main lending criteria (they are not credit rated) but have been included as a local policy decision. Last year, Executive and Resources Planning Workshop expressed that consideration be given to making deposits with these local institutions recognising the contribution they make to the local economy and the opportunity for the Council to potentially secure better short term lending rates.
- 2.5 In consultation with the Council's Treasury Management Advisors, the level of risk considered to be acceptable if investments with the Cumberland and Furness Building Societies are limited to £1 million each and with the length of investment restricted to a 4 month maximum. At 19th November 2010, the

- 2.6 The Council's investment strategy is safeguarding the re-payment of the principal and interest of its investments on time – the investment return being a secondary objective. Following on from the economic background at 2.2 and 2.3 above, the current investment climate has one over-riding risk consideration, that of counterparty risk. The current counterparty criteria is under regular review, however no further amendments to the Treasury Management and Investment Strategies are sought at this point in time.
- 2.7 The Council still has the one remaining Market Loan in its debt portfolio, of £5 million. We continually assess the position of this loan with our Treasury Consultants, Sector, to see whether we are securing the best terms for the Council. At the current time, the advice is to leave this loan in its present form, as the penalty for repaying early would be prohibitive. The Capital Programme, does however, indicate the possibility of drawing upon this borrowing to support the funding of schemes in development of up to £2 million. This is set out in the Capital Programme 2011/12 – 2013/14 report elsewhere on the agenda. This draw down on borrowing already undertaken would be conditional upon Executive agreement of the scheme and a satisfactory PID which would demonstrate at least a return sufficient to repay the principal of the loan. The interest payments on the loan are currently provided for within the revenue budget.
- 2.8 Finally, in the event that borrowing is necessary, the Corporate Director for Resources and Transformation, under delegated powers, would take the most appropriate form of borrowing depending on the prevailing interest rates at the time and taking into account contemporaneous forecasts. Executive agreement would be sought and any amendment to the Treasury Management Strategy, if required, would be sought from Council.

3 FINANCIAL AND HUMAN RESOURCE IMPLICATIONS (INCLUDING SOURCES OF FINANCE)

- 3.1 Returns on investments support the Council's budget and the interest earned is included in the Accountancy Budget. A detailed projection of the return upon investments is undertaken when setting the budget and is regularly updated as part of the budget monitoring process.
- 3.2 The interest paid on the Council's existing borrowing is included in the revenue budget and again, is included in the Accountancy Budget.

4 PROJECT AND RISK MANAGEMENT

- 4.1 The policies and parameters set out in the report provide an approved framework within which the officers undertake the day to day capital and treasury activities.

- 4.2 The risk attached to investment decisions has been considered in recommending the Investment Strategy in consultation with our Treasury Management Advisors, Sector.

5 IMPACT ON CORPORATE PLAN

- 5.1 By ensuring that the Council utilises its resources effectively, Treasury Management supports the delivery of the Corporate Plan.

List of Appendices

Appendix A – The Capital Prudential Indicators 2011/12-2013/14

Appendix B – Treasury Management and Investment Strategy 2011/12-2013/14

Annex B1 – Credit and Counterparty Risk Management

Annex B2 – Security, Liquidity and Yield Benchmarking

List of Background Documents:

- Mid Year Prudential indicators and Treasury Management Monitoring Report to Executive 18 November 2010
- Treasury Management Strategy Report 2010/11-2012/13 to Council 2 March 2010

The Capital Prudential Indicators 2011/12 – 2013/14

Introduction

1. 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, reflecting the outcome of the Council's underlying capital appraisal systems. This report updates currently approved indicators and introduces new indicators for 2013/14.
2. 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 2011/12 to 2013/14 is included as Appendix B to complement these indicators. Some of the prudential indicators are shown in the treasury management strategy to aid understanding.

The Capital Expenditure Plans

3. The Council's capital expenditure plans are summarised below and this forms the first of the prudential indicators. A certain level of capital expenditure is grant supported by the Government; any decisions by the Council to spend above this level will be considered unsupported capital expenditure. This unsupported capital expenditure needs to have regard to:
 - Service objectives (e.g. strategic planning);
 - Stewardship of assets (e.g. asset management planning);
 - Value for money (e.g. option appraisal);
 - Prudence and sustainability (e.g. implications for external borrowing and whole life costing);
 - Affordability (e.g. implications for the council tax and rents);
 - Practicality (e.g. the achievability of the forward plan).
4. The revenue consequences of capital expenditure, particularly the unsupported capital expenditure, will need to be paid for from the Council's own resources.
5. This capital expenditure can be paid for immediately (by applying capital resources such as capital receipts, capital grants etc., or revenue resources), but if these resources are insufficient any residual capital expenditure will add to the Council's borrowing need.
6. The key risks to the plans are that the level of Government support has been estimated and is therefore maybe subject to change. Similarly some estimates for other sources of funding, such as capital receipts, may also be subject to change over this timescale. For instance anticipated asset sales may be postponed and/or the receipt being lower than anticipated due to the poor condition of the property market.

7. The Council is asked to approve the summary capital expenditure projections below. This forms the first prudential indicator:

| £m | 2010/11 Original | 2010/11 Revised | 2011/12 Estimate | 2012/13 Estimate | 2013/14 Estimate |
|--|---------------------|--------------------|---------------------|---------------------|---------------------|
| Capital Expenditure | 7,600 | 5,263 | 4,546 | 1,875 | 1,753 |
| Financed by: | | | | | |
| Capital receipts | 2,993 | 2,617 | 1,750 | 1,111 | 989 |
| Capital grants | 2,581 | 2,614 | 777 | 764 | 764 |
| Capital reserves | 0 | 0 | 0 | 0 | 0 |
| Revenue | 26 | 32 | 19 | 0 | 0 |
| Net financing need for the year | 2,000 | 0 | 2,000 | 0 | 0 |

8. Other long term liabilities – The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments. Members were advised 18th November 2010 of the PFI ‘coming on balance sheet’ as at 31 March 2010, as a result of International Financial Reporting Standards (IFRS). Further work is currently being undertaken to assess the impact of full IFRS compliance which is applicable to 2010/11 accounts, and may impact on current leasing arrangements.

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

9. 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. The capital expenditure above which has not immediately been paid for will increase the CFR.
10. Following accounting changes the CFR includes any other long term liabilities (e.g. PFI schemes) brought onto the balance sheet. Whilst this increases 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 this scheme. The Council currently has £6.6m of such schemes within the CFR.
11. The Council is asked to approve the CFR projections below:

* Cannot quantify until works completed - will update for Council

| £m | 2010/11 Original | 2010/11 Revised | 2011/12 Estimate | 2012/13 Estimate | 2013/14 Estimate |
|--------------------------------------|---------------------|--------------------|---------------------|---------------------|---------------------|
| Capital Financing Requirement | | | | | |
| Total CFR | 1,953 | 8,462 | 10,462 | 10,462 | 10,462 |
| Movement in CFR | 2,000 | 0 | 2,000 | 0 | 0 |

| Movement in CFR represented by | | | | | |
|--|--------------|----------|----------|----------|----------|
| Net financing need for the year (above) | 2,000 | 0 | 2,000 | 0 | 0 |
| Less MRP/VRP and other financing movements | 0 | * | * | * | * |
| Movement in CFR | 2,000 | * | * | * | * |

12. 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).

Minimum Revenue Provision Statement 2011/12

13. 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:
14. For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:
- **Existing practice** - MRP will follow the existing practice outlined in former CLG Regulations (Option 1);

This provides for an approximate 4% reduction in the borrowing need (CFR) each year.

15. 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 proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (Option 3); (Jo – Please can you confirm/decide if this is still appropriate and which method – equal instalments or annuity?)

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

The Use of the Council's Resources and the Investment Position

16. 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.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

| Year End Resources £m | 2010/11 Original | 2010/11 Revised | 2011/12 Estimate | 2012/13 Estimate | 2013/14 Estimate |
|-----------------------------|---------------------|--------------------|---------------------|---------------------|---------------------|
| Fund balances | 2,091 | 3,241 | 3,241 | 3,241 | 3,241 |
| Capital receipts | 4,262 | 4,484 | 3,180 | 4,806 | 5,247 |
| Earmarked reserves | 4,410 | 4,976 | 4,243 | 4,403 | 4,408 |
| Provisions etc. | 751 | 144 | 144 | 144 | 144 |
| Total Core Funds | 11,514 | 12,845 | 10,808 | 12,594 | 13,040 |
| Working Capital* | (1,837) | (595) | (595) | (595) | (595) |
| Under/over borrowing** | 1,407 | 3,111 | 1,111 | 1,111 | 1,111 |
| Expected Investments | 11,084 | 15,361 | 11,324 | 13,110 | 13,556 |

*Working capital balances shown are estimated year end; these may be higher mid year

Affordability Prudential Indicators

17. 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:

18. **Actual and Estimates of the 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.

| % | 2010/11 Original | 2010/11 Revised | 2011/12 Estimate | 2012/13 Estimate | 2013/14 Estimate |
|-------|---------------------|--------------------|---------------------|---------------------|---------------------|
| Ratio | 1% | 2% | 2% | 2% | 2% |

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

20. **Estimates of the incremental impact of capital investment decisions on the 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.

21. **Incremental impact of capital investment decisions on the Band D Council Tax**

| £ | Original 2010/11 | Proposed Budget 2010/11 | Forward Projection 2011/12 | Forward Projection 2012/13 | Forward Projection 2013/14 |
|---------------------------------|---------------------|-------------------------------|----------------------------------|----------------------------------|----------------------------------|
| Council Tax - Band D | * | * | * | * | * |

Note as the capital programme 2011/12-2013/14 has not yet been approved and the Council Tax figures are not yet available.

***THESE FIGURES ARE NOT YET PREPARED AND THIS REPORT WILL BE UPDATED AS SOON AS INFORMATION BECOMES AVAILABLE.**

Treasury Management Strategy 2011/12 – 2013/14

1. The treasury management service is an important part of the overall financial management of the Council's affairs. The prudential indicators in Appendix A consider the affordability and impact of capital expenditure decisions, and set out the Council's overall capital framework. The treasury service considers the effective funding of these decisions. Together they form part of the process which ensures the Council meets its balanced budget requirement under the Local Government Finance Act 1992. .
2. The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management). This Council adopted the Code of Practice on Treasury Management on 14th March 2002 and consequently adopted the revised code of November 2009.
3. As a result of adopting the Code the Council also adopted a Treasury Management Policy Statement (24th February 2004). This adoption is the requirements of one of the prudential indicators.
4. The policy requires an annual strategy to be reported to Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. A further treasury report is produced after the year-end to report on actual activity for the year, and a new requirement of the revision of the Code of Practice is that there is a mid-year monitoring report.
5. This strategy covers:
 - The Council's debt and investment projections;
 - The Council's estimates and limits on future debt levels;
 - The expected movement in interest rates;
 - The Council's borrowing and investment strategies;
 - Treasury performance indicators;
 - Specific limits on treasury activities;
 - Any local treasury issues.

Debt and Investment Projections 2011/12 – 2013/14

6. The borrowing requirement comprises the expected movement in the CFR and any maturing debt which will need to be re-financed. The table 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. Members will recall that this was amended to £12m in the Treasury Management Mid-Year Report presented to Executive on 18th November 2010 and so may be different from the year end position. The table also highlights the expected change in investment balances.

| £m | 2010/11 Revised | 2011/12 Estimate | 2012/13 Estimate | 2013/14 Estimate |
|-----------------------------------|-----------------|------------------|------------------|------------------|
| External Debt | | | | |
| Debt at 1 April : | | | | |
| Borrowing | 5,100 | 5,100 | 5,100 | 5,100 |
| Other long term liabilities (PFI) | 6,572 | 6,335 | 6,112 | 5,869 |
| Debt at 31 March | 11,672 | 11,435 | 11,212 | 10,969 |
| Operational Boundary | 12,000 | 12,000 | 12,000 | 12,000 |
| Investments | | | | |
| Total Investments at 31 March | 15,361 | 11,324 | 13,110 | 13,556 |
| Investment change | (3,642) | (4,037) | 1,786 | 446 |

7. The related impact of the above movements on the revenue budget are:

| £m | 2010/11 Revised | 2011/12 Estimate | 2012/13 Estimate | 2013/14 Estimate |
|------------------------|-----------------|------------------|------------------|------------------|
| Revenue Budgets | | | | |
| Interest on Borrowing | 0 | 0 | 0 | 0 |
| Investment income | (25) | (77) | (118) | (174) |

Limits to Borrowing Activity

8. Within the prudential indicators there are a number of key indicators to ensure the Council operates its activities within well defined limits.
9. 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 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.

| £m | 2010/11 Revised | 2011/12 Estimate | 2012/13 Estimate | 2013/14 Estimate |
|----------------------------------|-----------------|------------------|------------------|------------------|
| External Loans | 5,100 | 5,100 | 5,100 | 5,100 |
| Plus Other long term liabilities | 6,572 | 6,335 | 6,112 | 5,869 |
| Gross Borrowing | 11,672 | 11,435 | 11,212 | 10,969 |
| Less Investments | (15,361) | (11,324) | (13,110) | (13,556) |
| Net Borrowing | (3,689) | 111 | (1,898) | (2,587) |
| CFR* | 8,462 | 10,462 | 10,462 | 10,462 |

* - Under the Prudential Code revision, any falls in the CFR are ignored.

10. The Corporate Director for Resources and Transformation 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.
11. The Authorised Limit for External Debt – A further key prudential indicator represents a control on the overall level of borrowing. This represents a limit

12. 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.

13. The Council is asked to approve the following Authorised Limit:

| Authorised limit £m | 2010/11 Revised | 2011/12 Estimate | 2012/13 Estimate | 2013/14 Estimate |
|-----------------------------|------------------------|-------------------------|-------------------------|-------------------------|
| Borrowing | 9,000 | 9,000 | 9,000 | 9,000 |
| Other long term liabilities | 8,000 | 8,000 | 8,000 | 8,000 |
| Total | 17,000 | 17,000 | 17,000 | 17,000 |

14. Members will recall the authorised limit was changed from £9m to £17m by Council following presentation of the Treasury Management 2010/11 – Mid Year Prudential Indicators and Treasury Management Monitoring Report to Executive 18th November 2010. This was as a direct consequence of a changing in accounting standards (IFRS) which necessitated bringing the PFI 'on balance sheet'. As noted in point 8 Appendix A (page 7) there may be a further impact on the reporting of long term liabilities as a result of full IFRS compliance. This may require both the Operational Boundary and the Authorised Limit to be reset to accommodate this accounting change. If this is the case, it will be reflected in the budget report presented to Council in February 2011.

15. Borrowing in advance of need – The Council has some flexibility to borrow funds this year for use in future years. The Corporate Director for Resources and Transformation 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 Corporate Director for Resources and Transformation 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. Borrowing in advance will be made within the constraints that:

- It will be limited to no more than 50% of the expected increase in borrowing need (CFR) over the three year planning period; and
- Would not look to borrow more than 18 months in advance of need. (Jo – Please confirm if both limits are acceptable or advise otherwise)

16. 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

Medium-Term Rate Estimates (averages)

| Annual Average % | Bank Rate | Money Rates | | PWLB Rates* | | |
|------------------|-----------|-------------|--------|-------------|---------|---------|
| | | 3 month | 1 year | 5 year | 25 year | 50 year |
| 2010/11 | 0.5 | 0.7 | 1.5 | 2.6 | 4.6 | 4.7 |
| 2011/12 | 0.7 | 1.0 | 1.8 | 3.3 | 5.3 | 5.4 |
| 2012/13 | 1.7 | 2.0 | 2.8 | 4.2 | 5.5 | 5.6 |
| 2013/14 | 3.1 | 3.2 | 3.7 | 4.8 | 5.6 | 5.7 |
| 2014/15 | 4.0 | 4.2 | 4.5 | 5.6 | 5.6 | 5.8 |
| 2015/16 | 4.0 | 4.2 | 4.2 | 5.3 | 5.5 | 5.5 |

* Borrowing Rates

17. Short-term rates are expected to remain on hold for a considerable time. The recovery in the economy has commenced and recent growth data has come in at the high side of expectations. Nevertheless, this higher rate is unlikely to be sustained, with growth expected to revert back to more insipid levels. The danger of a double-dip recession is fading but the crisis in the euro-zone, the prospects of tight economic policies at home and tenuous consumer confidence means the threat has still not evaporated completely.
18. The Office for Budget Responsibility has presented a realistically downbeat view of the economy's recovery prospects over the short and medium term, projecting that growth will struggle to exceed its trend rate in the current parliament. The Government's determination to cut the size of the public sector deficit considerably more quickly than its predecessor will be a drag upon activity in the medium term.
19. The void left by significant cuts in public spending will have to be filled by a number of alternatives – corporate investment, rising exports and consumers' expenditure. In terms of sheer magnitude, the latter is the most important and a strong recovery in this area is by no means certain. The combination of the desire to reduce the level of personal debt and continued job uncertainty is likely to weigh heavily upon spending. This will be amplified by fiscal policy tightening, outlined in the Budget and expanded upon in the 20 October Comprehensive Spending Review. Without a rebound in personal spending, any recovery in the economy is set to be weak and protracted.
20. The Bank of England admits that inflation will remain above target until 2012. Inflation performance remains a key risk to the future course of interest rates. Nevertheless, the perceived need to counter the fiscal squeeze via accommodative monetary policy suggests that barring a deterioration from the current situation, the MPC will be prepared to hold rates at very low levels until the latter stages of 2011.
21. The outlook for long-term interest rates is favourable in the near term but is set to deteriorate in the latter part of 2011. Yields will be suppressed by continued investor demand for safe haven instruments following the uncertainties and unfolding tensions within the entire Eurozone. In addition to this, the market has been underpinned by evidence of decelerating activity in major economies and the coalition government's apparent determination to deal with the parlous state of public sector finances. These two factors will restrict any deterioration in gilt market performance in the near term.
22. However, while the UK's fiscal burden will almost certainly ease, it will be a lengthy process and deficits over the next two to three financial years will still require a very heavy programme of gilt issuance. The latest Bank Inflation

23. Eventually, the absence of the Bank of England as the largest buyer of gilts will shift the balance between supply and demand in the gilt-edged market. Other investors will almost certainly require some incentive to continue buying government paper.
24. This incentive will take the form of higher yields. The longer end of the curve will suffer from the lack of support from the major savings institutions – pension funds and insurance companies - who will continue to favour other investment instruments as a source of value and performance.
25. The front end of the curve will benefit from heavy purchases by banks as they seek to meet the FSA's proposed liquidity requirements. This will be a major benefit to the Government's gilt funding operations in the near term and will ensure the steeply-positive incline of the yield curve remains intact.

Borrowing Strategy 2011/12 – 2013/14

26. 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.
27. Long-term fixed interest rates are at risk of being higher over the medium term, and short term rates are expected to rise, although more modestly. The Corporate Director for Resources and Transformation, 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; but at this time it is not anticipated any further external borrowing will be necessary. It is likely that shorter term fixed rates may provide lower cost opportunities in the short/medium term.
28. The Corporate Director for Resources and Transformation and treasury consultants will monitor prevailing rates for any opportunities during the year but it is thought unlikely that the outstanding debt will be able to be repaid in the year.
29. In the unlikely event of a need to borrow, the option of postponing this, and running down investment balances would also be considered. This would reduce counterparty risk and hedge against the expected fall in investments returns.

Investment Strategy 2011/12 – 2013/14

30. **Key Objectives** - The Council's investment strategy primary objectives are safeguarding the re-payment of the principal and interest of its investments on time; then ensuring adequate liquidity, with the investment return being the final objective. Following the economic background above, the current investment climate has one over-riding risk, counterparty security risk. 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.
31. **Risk Benchmarking** – A development in the revised Codes and the CLG Investment Guidance 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 the Member reporting, although the application of these is

32. These benchmarks are simple guides to maximum risk and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

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

- 0.1% historic risk of default when compared to the whole portfolio.

34. Liquidity – In respect of this area the Council seeks to maintain:

- Bank overdraft - £0.5m
- Liquid short term deposits of at least £1m available with a week's notice.
- Weighted Average Life benchmark is expected to be 0.3 years, with a maximum of 1.0 years. (Jo – Comment please, currently leaving as 3 months and 1 year as no evidence to support a change in current policy)

35. Yield - Local measures of yield benchmarks are:

- Investments – Internal returns above the 7 day LIBID rate

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

| | 1 year | 2 years | 3 years |
|---------|--------|---------|---------|
| Maximum | 0.1% | 0.22% | 0.37% |

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

37. **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:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections below.
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

38. The Corporate Director for Resources and Transformation 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.

39. 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

40. 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 (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance a negative rating watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.
41. The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments – see Annex B1 pages 21 & 22 of this report for criteria) is:

- **Banks 1 - Good Credit Quality** – the Council will only use banks which:

- i. Are UK banks; and/or
- ii. Are non-UK and domiciled in a country which has a minimum Sovereign long term rating of **AAA**

And have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):

- i. **Short Term** – **F1**
 - ii. **Long Term** – **A**
 - iii. **Individual / Financial Strength** – **C** (Fitch / Moody's only)
 - iv. **Support** – **4** (Fitch only)
- **Banks 2 – Guaranteed Banks with suitable Sovereign Support** – In addition, the Council will use banks whose ratings fall below the criteria specified above if all of the following conditions are met:
 - (a) wholesale deposits in the bank are covered by a government guarantee;
 - (b) the government providing the guarantee is rated “AAA” by all three major rating agencies (Fitch, Moody's and Standard & Poor's); and
 - (c) the Council's investments with the bank are limited to amounts and maturities within the terms of the stipulated guarantee.
 - **Banks 3 – Eligible Institutions** - The organisation was considered 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 were subject to suitability checks before inclusion.
 - **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.

- **Bank Subsidiary and Treasury Operations** – the Council will use these where the parent bank has the necessary ratings outlined above.
- **Building Societies** – the Council will use all Societies which are both:
 - i. Eligible Institutions; and
 - ii. Have assets which place them in the top 30 building societies
- **Money Market Funds – AAA**
- **UK Government** (including gilts and the DMADF)
- **Local Authorities, Parish Councils etc**
- **Supranational institutions**

A limit of **75%** will be applied to the use of Non-Specified investments.

42. **Country and sector considerations** - Due care will be taken to consider the country, group and sector exposure of the Council's investments. In part the country selection will be chosen by the credit rating of the Sovereign state in Banks 1 above. In addition:

- no more than **50%** will be placed with any non-UK country at any time;
- limits in place above will apply to Group companies;
- Sector limits will be monitored regularly for appropriateness.

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

44. **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):

| | Fitch (or equivalent) | Money Limit | Time Limit |
|--------------------------|----------------------------------|--------------------|-------------------|
| Limit 1 Category | AA | £5m | 3yrs |
| Limit 2 Category | A- | £5m | 1yrs |
| Limit 3 Category | | £5m | 1yrs |
| Other Institution Limits | - | £5m | 3yrs |
| Guaranteed Organisations | - | £5m | 1yr |

45. The proposed criteria for Specified and Non-Specified investments are shown in Annex B1 for approval.

46. 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.
47. 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.
48. **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/late-2011. The Council's investment decisions are based on comparisons between the rises priced into market rates against the Council's and advisers own forecasts.
49. **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 Corporate Director for Resources and Transformation 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.**
50. 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, and strongly rated institutions. The credit criteria have been amended to reflect these facilities.
51. With regard to the Cumberland and Furness Building Societies which would not fulfil the temporarily restricted criteria a special case can be made for restarting investments with these counterparties. The level of risk is considered to be acceptable if investments are limited to £1million with each of the counterparties and the length of the investments is restricted to a four month maximum.

Sensitivity to Interest Rate Movements

52. 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.

| £m | 2011/12 Estimated + 1% | 2011/12 Estimated - 1% |
|------------------------|------------------------------|------------------------------|
| Revenue Budgets | | |
| Interest on Borrowing | 0 | 0 |
| Investment income | 250 | (250) |

Treasury Management Limits on Activity

53. 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:

- 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.
- 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.
- 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.

54. The Council is asked to approve the limits:

| £m | 2011/12 | 2012/13 | 2013/14 |
|--|--------------|--------------|--------------|
| Interest rate Exposures | | | |
| | Upper | Upper | Upper |
| Limits on fixed interest rates based on net debt | 5,100 | 5,100 | 5,100 |
| Limits on variable interest rates based on net debt | 5,100 | 5,100 | 5,100 |
| Limits on fixed interest rates: | | | |
| • <i>Debt only</i> | 5,100 | 5,100 | 5,100 |
| • <i>Investments only</i> | 30,000 | 30,000 | 30,000 |
| Limits on variable interest rates | | | |
| • <i>Debt only</i> | 5,100 | 5,100 | 5,100 |
| • <i>Investments only</i> | 20,000 | 20,000 | 20,000 |
| Maturity Structure of fixed interest rate borrowing 2011/12 | | | |
| | Lower | Upper | |
| Under 12 months | 0% | 50% | |
| 12 months to 2 years | 0% | 0% | |
| 2 years to 5 years | 0% | 0% | |
| 5 years to 10 years | 0% | 0% | |
| 10 years to 20 years | 0% | 0% | |
| 20 years to 30 years | 0% | 0% | |
| 30 years to 40 years | 0% | 100% | |
| 40 years and above | 0% | 0% | |
| Maximum principal sums invested > 364 days | | | |
| Principal sums invested >364 days | £m 12,000 | £m 12,000 | £m 12,000 |

Performance Indicators

55. 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:

- Investments – Internal returns above the 7 day LIBID rate

The results of these indicators will be reported in the Treasury Annual Report.

Treasury Management Advisers

56. The Council uses Sector as its treasury management consultants. The company provides a range of services which include:

- Technical support on treasury matters, capital finance issues and the drafting of Member reports;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments;
- Credit ratings/market information service comprising the three main credit rating agencies;

57. 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

58. 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. Ensuring new members of staff involved in the treasury process attend training courses provided by our treasury advisors, Sector.
- b. (Jo – Members training, last one delivered by Butlers - now Sector - March 2009 with a follow up November 2009, something to discuss with Richard?)

Local Issues

59. The Council still has one remaining Market Loan in its debt portfolio, of £5million. The position of this loan is continually assessed with our Treasury Consultants, Sector to ensure we are securing the best terms for the Council. At the current time, the advice is to leave this loan in its present form because of the large premium for premature repayment.

60. The Council is alert to the possibility that it may become the subject of an attempt to involve it in a transaction involving the laundering of money. Accordingly, it will maintain procedures for verifying and recording the identity of counterparties and reporting suspicions, and will ensure that any staff involved in treasury management are properly trained.

Treasury Management Practice (TMP) 1 – Credit and Counterparty Risk Management

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

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 14th March 2002 and will apply its principles to all investment activity. In accordance with the Code, the Corporate Director for Resources and Transformation has produced its treasury management practices (TMPs). This part, TMP 1(5), covering investment counterparty policy requires approval each year.

Annual Investment Strategy - 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:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- 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.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Council is:

Strategy Guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified Investments – 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:

1. The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.
3. A local authority, parish council or community council.
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this covers

5. A body that is considered of a high credit quality (such as a bank or building society). For category 5 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.

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. This criteria is **a maximum amount of £5M for a maximum period of 3 years.**

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

| | Non Specified Investment Category | Limit (£ or %) |
|----|---|---|
| a. | <p>Supranational Bonds greater than 1 year to maturity</p> <p>(a) Multilateral development bank bonds - These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Investment Bank etc.)</p> <p>(b) A financial institution that is guaranteed by the United Kingdom Government (e.g. The Guaranteed Export Finance Company {GEFCO})</p> <p>The security of interest and principal on maturity is on a par with the Government and so very secure, and these bonds usually provide returns above equivalent gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.</p> | <p>AAA long term ratings</p> <p>5M for 3 years</p> <p>5M for 3 years</p> |
| b. | <p>Gilt edged securities with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.</p> | 5M |
| c. | <p>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. (Jo – Previous change from £10k due to the closure of the Special Interest Bearing Account)</p> | 5K |
| d. | <p>Building societies not meeting the basic security requirements under the specified investments. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The Council may use such building societies which were originally considered Eligible Institutions and are listed in the top 30 building societies, but will restrict these type of investment to 1 year in length.</p> | 5M for 1 year |

| | | |
|----|---|--|
| e. | Any bank or building society that has a minimum long term credit rating of A , for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment). | Maximum limit of 100%, but no more than £12M of investments to have maturities of longer than one year at any one time. |
| f. | Any non rated subsidiary of a credit rated institution included in the specified investment category. These institutions will be included as an investment category subject to the parent institution having a minimum rating of A (or the equivalent) as rated by Standard & Poor's, moody's or Fitch rating agencies. | 5M for 365 Days |

Within categories d and e, and in accordance with the Code, the Council has developed additional criteria to set the overall amount of monies which will be invested in these bodies. This criteria is **that a maximum amount of £18M will be invested over both categories but the length of investments will be limited to the timescale of the guarantee or 1 year whichever is the shorter period.**

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

Security, Liquidity and Yield Benchmarking

Benchmarking and Monitoring Security, Liquidity and Yield in the Investment Service - A proposed development for Member reporting is the consideration and approval of security and liquidity benchmarks.

These benchmarks are targets and so may be breached from time to time. Any breach will be reported, with supporting reasons in the Annual Treasury Report.

Yield – These benchmarks are currently widely used to assess investment performance. Local measures of yield benchmarks are:

- Investments – Internal returns above the 7 day LIBID rate

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.

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:

- Bank overdraft - £0.5m
- Liquid short term deposits of at least £1m available with a week’s notice.

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 0.3 years, with a maximum of 1 years.

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 Poor’s). 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/Moody’s Standard and Poor’s long term rating category over the period 1990 to 2009.

| Years | 1 | 2 | 3 | 4 | 5 |
|-------|--------|--------|--------|--------|--------|
| AAA | 0.00% | 0.01% | 0.05% | 0.10% | 0.17% |
| AA | 0.03% | 0.06% | 0.08% | 0.14% | 0.20% |
| A | 0.08% | 0.22% | 0.37% | 0.52% | 0.70% |
| BBB | 0.24% | 0.68% | 1.19% | 1.79% | 2.42% |
| BB | 1.22% | 3.24% | 5.34% | 7.31% | 9.14% |
| B | 4.06% | 8.82% | 12.72% | 16.25% | 19.16% |
| CCC | 24.03% | 31.91% | 37.73% | 41.54% | 45.22% |

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

The Council's maximum security risk benchmark for the whole portfolio, when compared to these historic default tables, is:

- 0.1% 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 | 0.1% | 0.22% | 0.37% |

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.