

**PROPOSED TREASURY MANAGEMENT STRATEGY 2012/13 - 2014/15
incorporating ANNUAL INVESTMENT STRATEGY 2012/13 &
MINIMUM REVENUE PROVISION STATEMENT 2012/13**

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This report was presented to Resource Planning Working Group on 6th December 2011 making recommendations to Executive on 20th December 2011. This report will be presented at Full Council on 23rd February 2012.

This report is presented to this meeting today for note prior to its presentation to Executive at its meeting of the 14th February 2012 at which, Executive will be asked to make their recommendations on this report to Council for its meeting on 23rd February 2012.

1.Introduction

1.1 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.

CIPFA defines treasury management as:

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

1.2 Reporting requirements

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

These reports are required to be adequately scrutinised by committee before being recommended to the Council. This role is undertaken by the Audit Committee.

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 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. This report was presented to Executive on 22 November 2011.

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.

1.3 Treasury Management Strategy for 2012/13

The strategy for 2012/13 covers two main areas:

Capital Issues

- the capital plans and the prudential indicators - setting out the expected capital activities;
- the MRP strategy – detailing how the Council will pay for capital assets through revenue each year.

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;
- debt rescheduling;
- 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 MRP Guidance, the CIPFA Treasury Management Code and the CLG Investment Guidance.

2. The Capital Prudential Indicators 2012/13 – 2014/15

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans are reflected in

prudential indicators, which are designed to assist members overview and confirm capital expenditure plans.

Capital Expenditure Prudential Indicator.

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, the detail of which is elsewhere on this agenda for consideration:

Capital Expenditure £000's	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Total	3,353	3,427	1,544	1,100	590

The above financing need excludes other long term liabilities, such as PFI and leasing arrangements.

The table below details how the above capital expenditure plans are to be financed by capital or revenue resources.

Capital Expenditure £000's	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Capital Expenditure:	3,353	3,427	1,544	1,100	590
Financed by:					
Capital receipts	1,712	1,726	1,234	850	340
Capital grants	1,539	1,701	310	250	250
Revenue	102	0	0	0	0
Net financing need for the year	0	0	0	0	0

Prudential Indicator: 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, which will not immediately been paid for, will increase the CFR, note: the above financing indicated that this is not applicable to Copeland.

Following accounting changes the CFR includes any other long term liabilities (e.g. PFI schemes, finance leases) brought onto the balance sheet. Whilst this change 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 these schemes. The Council currently has £7.2m of such schemes within the CFR.

The Council is asked to approve the CFR projections below:

£000's	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Capital Financing Requirement					
Total CFR	8,809	8,419	7,999	7,523	7,091
Movement in CFR	0	(390)	(420)	(476)	(432)

Movement in CFR represented by					
Net financing need for the year (above)	0	0	0	0	0
Less MRP/VRP and	0	(390)	(420)	(476)	(432)

other financing movements					
Movement in CFR	0	(390)	(420)	(476)	(432)

*Figures in brackets in the above table indicate the anticipated level of repayment for PFI/Finance Leases

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

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 £000's	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Fund balances	3,389	3,301	3,301	3,301	3,301
Capital receipts	4,237	4,300	6,607	9,161	8,927
Earmarked reserves	6,155	3,768	3,505	3,347	3,195
Provisions	118	118	118	118	118
Total Core Funds	13,899	11,487	13,531	15,927	15,541
Working Capital*	1,552	1,552	1,552	1,552	1,552
Under/over borrowing	3,407	3,407	3,407	3,407	3,407
Expected Investments	18,858	16,446	18,490	20,886	20,500

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

Affordability Prudential Indicators

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:

a) 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.

%	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Ratio	5.43%	6.55%	6.67%	6.32%

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

Prudential Indicator: 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 (presented elsewhere on this agenda for consideration) 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. The proposed Draft Capital Programme 2012/13 has no effect on the revenue budget and indicates no impact on Band D Council tax as shown below:

£	Original 2010/11	Revised Budget 2010/11	Forward Projection 2011/12	Forward Projection 2012/13	Forward Projection 2013/14
Council Tax - Band D	0	0	0	0	0

3. Minimum Revenue Provision (MRP) Policy Statement

Authorities are not required to raise Council tax to cover depreciation, impairment losses or amortisation; however they are required to set aside a minimum (prudent) amount of revenue to contribute towards capital expenditure financed by borrowing or credit arrangements. The broad aim of the provision is to ensure that the debt is repaid over the life of the asset.

The Council is required to pay off an element of the historic unfunded capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP).

MRP has existed for many years and the charge each year was a fixed rate of 4% of debt. The historical MRP calculation was based on 4% of a defined CFR level. In recent years there has been a move to make the MR charge linked to the asset for which the debt was incurred.

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

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); *or*
- **Based on CFR** – MRP will be based on the CFR (option 2);

These options provide for an approximate 4% reduction in the borrowing need (CFR) each year.

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);
- **OR Depreciation method** – MRP will follow standard depreciation accounting procedures (option 4);

These options provide for a reduction in the borrowing need over approximately the asset's life.

Repayment in year for annual PFI or finance leases can be substituted as MRP.

4. Treasury Management Strategy

The capital expenditure plans set out in Section 2 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 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 appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

4.1 Current Portfolio Position

The Council's treasury portfolio position at 31 March 2011, with forward projections are summarised below. The table shows the actual external borrowing, against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting an overborrowing position.

£000's	Ref	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
External borrowing						
Borrowing at 1 April		5,000	5,000	5,000	5,000	5,000
Expected change in borrowing		0	0	0	0	0
Other long-term liabilities (OLTL)		7,216	6,826	6,406	5,930	5,498
Expected change in OLTL		0	(390)	(420)	(476)	(432)
Actual borrowing at 31 March	a	12,216	11,826	11,406	10,930	10,498
CFR – the borrowing need	b	8,809	8,419	7,999	7,523	7,091
Under / (over) borrowing	b-a	(3,407)	(3,407)	(3,407)	(3,407)	(3,407)
Investments	c	18,858	16,446	18,490	20,886	20,500
Total investments at 31 March						
Net borrowing*	a-c	(6,642)	(4,620)	(7,084)	(9,956)	(10,002)

*Actual borrowing less investments

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its total 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 2012/13 and the following two financial years (shown as net borrowing above). This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

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.

4.2 Treasury Indicators – Limits to Borrowing Activity

The Operational Boundary Prudential Indicator

This is the limit beyond which external borrowing 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 borrowing.

Operational boundary £000's	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Borrowing	5,000	5,000	5,000	5,000
Other long term liabilities	7,000	7,000	7,000	7,000
Total	12,000	12,000	12,000	12,000

The Authorised Limit Prudential Indicator

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

This is a 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.

Authorised limit £000's	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Borrowing	7,000	7,000	7,000	7,000
Other long term liabilities	10,000	10,000	10,000	10,000
Total	17,000	17,000	17,000	17,000

4.3 Borrowing Strategy

Due to the recent increase in risks within the economic forecast, caution will be adopted with the 2012/13 treasury operations. The Corporate Director for Resources and Transformation will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

The Council's debt portfolio contains one remaining Market Loan 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.

Although, at this time it is not anticipated any further borrowing will be necessary, in the unlikely event of a need to borrow, the Corporate Director for Resources & Transformation, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time.

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

Treasury Management Limits on Activity

We have three debt related treasury activity limits:

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

The purpose of these limits is to manage risk and remove the impact of any adverse movement in interest rates.

The limits are set as detailed below:

£000's	2012/13	2013/14	2014/15
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
a) 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
b) Limits on variable interest rates			
• <i>Debt only</i>	5,100	5,100	5,100
• <i>Investments only</i>	30,000*	30,000*	30,000*
c) Maturity Structure of fixed interest rate borrowing 2012/13			
	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 to 20 years	0	100%	
20 years to 30 years	0	100%	
30 years to 40 years	0	100%	

*This indicator was previously £20m, as it is based on the number of variable interest rate accounts we hold (previously 4 but currently 6 accounts) multiplied by the monetary limit that we can invest with each counterparty, which is £5m each.

**This Indicator has changed from last year due to a change in 2011 guidance notes in relation to the "call date" of our £5m LOBO (lenders option, borrowers option) loan. In basic terms, the borrower has the right to request that the principal is repaid upon the date that the interest is repaid, which for Copeland is twice yearly. This is reflected by 100% maturity indicated in every category above. The likelihood of this happening is minimal given the rate of return that we are currently obligated to pay. Additionally, if there are any changes to the current loan agreement, we have the opportunity to repay the principal without any penalties, which would not be financially beneficial to the loan company.

Single Investment Transaction Limit

Every investment transaction will be subject to a maximum single investment transaction limit of £5m per counterparty.

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 risks associated will be approved and reported through the standard reporting method. Value for money and the security of such funds will also be considered.

Debt Rescheduling

Short term borrowing rates will be considerably cheaper than longer term fixed interest rates, which may present potential opportunities to generate savings by switching from long term debt to short term debt. However, at this moment the cost of repaying our £5m debt is prohibitive.

Any rescheduling decision made by the Director for Resources and Transformation will be reported to the Council, at the earliest meeting following its action.

Prospect for Interest Rates

The Council has appointed Sector as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Appendix 1 draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates which are summarised below:

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

Sector, our Treasury Management Advisors have provided the following narrative:

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

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

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

- The Eurozone sovereign debt difficulties, most evident in Greece, provide a clear indication of much higher counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2012/13;
- Borrowing interest rates are currently attractive, but may remain low for some time. The timing of any borrowing will need to be monitored carefully;
- There will remain a cost of capital – any borrowing undertaken that results in an increase in investments will incur a revenue loss between borrowing costs and investment returns.

5. Annual Investment Strategy

5.1 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, then return.

Investment instruments identified for use in the financial year are listed in appendix 3 under the 'Specified' Investments (ie investments with maturities of upto a maximum of one year meeting the high quality criteria) and 'Non-Specified' Investments Categories (ie all other investments that do not meet the Specified criteria). Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

Members will note that the Investment Strategy includes the option to lend on a short term basis to the local building societies of the Cumberland and Furness Building Societies. These institutions fall below the Council's main lending criteria (they are not credit rated and are currently rated below the top ten building societies) but as Executive and Resource Planning Working Group had previously expressed that consideration be given to making deposits with these local institutions recognising the contribution they make to the local economy, they had been included.

Investments with the Cumberland and Furness Building Societies will remain limited to £1 million each and with the length of investment restricted to a 3 month maximum. Both institutions rank 12 & 16 respectively in the top 30 building societies who choose not to be rated by the credit rating institutions.

5.2 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, Moodys and Standard and Poors. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads (Credit Default Swap – a premium a borrower pays against default) to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach uses a weighted scoring system 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 duration for investments upto a maximum of 2 years:

This methodology goes beyond simply applying the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties. 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.

All credit ratings are monitored daily, 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.
- Additionally, the Council will be advised of other market data on a weekly basis. Extreme market movements may result in downgrade of an institution and/or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition to this external service the Council also uses market data and market information, with alone regards to government support for banks.

Country limits

Under normal market circumstances, the Council has determined that it will only use approved counterparties from countries outside the UK with a minimum sovereign credit rating of AAA from Fitch (or equivalent). 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 amended by officers should ratings change in accordance with this policy.

The current practice, as a result of the the recent economic crisis in the Eurozone, has been to introduce a self imposed temporary restriction so all investments are with UK based counterparties only. This was considered the best measure to safeguard the principal invested.

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 primary principle the Council will ensure that:

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

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

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

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

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

- 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. Viability / financial strength – C (Fitch / Moody's only)
 - iv. Support – 4 (Fitch only)
 - Banks 2 – Part nationalised UK banks – Lloyds Bank and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
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- Banks 3 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- Bank subsidiary and treasury operation - The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.
- Building Societies – the council will use all societies which:
 - i. meet the ratings for banks outlined above and/or
 - ii. Have assets which place them in the top ten rated building societies;
- Money Market Funds – AAA
- UK Government (including gilts and the DMADF)
- Local authorities, parish councils etc
- Supranational institutions

A limit of 50% will be applied to the use of Non-Specified investments. This has reduced from 75% from last year as a result of the current economic crisis and that currently we hold 100% specified investments.

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 outside the UK at any time;
- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

Use of additional information other than credit ratings

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

Time and monetary limits applying to investments

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 Long term Rating (or equivalent)	Money Limit	Time Limit
Banks 1 category high quality	AA-	£5m	3yrs
Banks 1 category medium quality	A-	£3m	1yr
Banks 2 category – part nationalised	N/A	£7.5m*	1yr
Limit 3 category – Council's banker (not meeting Banks 1)		£10k	1 day
Other institutions limit	-	£2m	1yr
DMADF	AAA	unlimited	6 months
Local authorities	N/A	£5m	1yr
Money market Funds	AAA	£5m	liquid

**This may be increased to an ultimate limit of £10m per semi nationalised Counterparty for short term investments only and solely with the prior approval of the Director for Resources and Transformation.*

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

5.3 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 3 of 2013. Bank Rate forecasts for each financial year end (March) are:

- 2011/ 2012 0.50%
- 2012/ 2013 0.50%
- 2013/ 2014 1.25%
- 2014/ 2015 2.50%

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 five years are as follows:

2012/13	0.70%
2013/14	1.00%
2014/15	1.60%
2015/16	3.30%
2016/17	4.10%

Against this view, we expect to be able to achieve rates of 1.25% on 3 month investments made with the semi nationalised institutions. This is based on rates currently achieved with these counterparties. It is understood, however, that these rates are not guaranteed and may change at any time.

For its cash flow generated balances, the Council will seek to utilise its business reserve accounts, 28, 60 and 90 day notice accounts, money market funds and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

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	
Principal sums invested > 364 days	£m
	12

5.4 Investment Risk Benchmarking

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

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.**

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.

Yield - local measures of yield benchmarks are:

- Investments – internal returns above the 7 day LIBID rate

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.

5.5 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.

5.6 Policy on the use of external service providers

The Council uses Sector as its external treasury management advisors.

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

5.7 Scheme of delegation

Please see Appendix 5.

5.8 Role of the section 151 officer

Please see Appendix 6.

6. Financial and Human Resource Implications (Including Sources of Finance)

Returns on investments support the Council's budget and the interest earned is included in the Finance 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.

The interest paid on the Council's existing borrowing is included in the revenue budget and again, is included in the Finance Budget.

7. Project and Risk Management

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.

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

8. Impact on Corporate Plan

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

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

List of Appendices:

1. Interest rate forecasts
 2. Economic background
 3. Treasury Management practice - Specified and non specified investments and limits
 4. Approved countries for investments
 5. Treasury management scheme of delegation
 6. The treasury management role of the section 151 officer
-

APPENDIX 1 - Interest Rate Forecast 2011/2015

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

APPENDIX 2 Economic Background

Global economy

The outlook for the global economy remains clouded with uncertainty with the UK economy struggling to generate sustained recovery that offers any optimism for the outlooks for 2011 and 2012, or possibly even into 2013. Consumer and business confidence levels are low and with little to boost sentiment, it is not easy to see potential for a significant increase in the growth rate in the short term.

At the centre of much of the uncertainty is the ongoing **Eurozone sovereign debt crisis** which has intensified, rather than dissipated throughout 2011. The main problem has been **Greece**, where, even with an Eurozone/IMF/ECB bailout package and the imposition of austerity measures aimed at deficit reduction, the lack of progress and the ongoing deficiency in addressing the underlying lack of competitiveness of the Greek economy, has seen an escalation of their problems. These look certain to result in a default of some kind but it currently remains unresolved if this will be either “orderly” or “disorderly”, and/or also include exit from the Euro bloc.

As if that were not enough there is growing concern about the situation in **Italy** and the risk that contagion has not been contained. Italy is the third biggest debtor country in the world but its prospects are limited given the poor rate of economic growth over the last decade and the lack of political will to address the need for fundamental reforms in the economy. The Eurozone now has a well established track record of always doing too little too late to deal with this crisis; this augurs poorly for future prospects, especially given the rising level of electoral opposition in northern EU countries to bailing out profligate southern countries.

The US economy offers little to lift spirits. With the next Presidential elections due in November 2012, the current administration has been hamstrung by political gridlock with the two houses split between the main parties. In quarter 3 the Federal Reserve started “Operation Twist” in an effort to re-ignite the economy in which growth is stalling. High levels of consumer indebtedness, unemployment and a moribund housing market are weighing heavily on consumer confidence and so on the ability to generate sustained economic growth.

Hopes for broad based recovery have, therefore, focussed on the **emerging markets** but these areas have been struggling with inflationary pressures in their previously fast growth economies. China, though, has maintained its growth pattern, despite tightening monetary policy to suppress inflationary pressures, but some forward looking indicators are causing concern that there may not be a soft landing ahead, which would then be a further dampener on world economic growth.

UK economy

The Government’s austerity measures, aimed at getting the public sector deficit into order over the next four years, have yet to fully impact on the economy. However, coming at a time when economic growth has virtually flatlined and concerns at the risk of a technical recession (two quarters of negative growth) in 2012, it looks likely that the private sector will not make up for the negative impact of these austerity measures given the lack of an export led recovery due to the downturn in our major trading partner – the EU. The housing market, a gauge of consumer confidence, remains weak and the outlook is for house prices to be little changed for a prolonged period.

Economic Growth. GDP growth has, basically, flatlined since the election of 2010 and, worryingly, the economic forecasts for 2011 and 2012 have been revised lower on a near quarterly basis as the UK recovery has, effectively, stalled. With fears of a potential

return to recession the Bank of England embarked on a second round of Quantitative Easing to stimulate economic activity.

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

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

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

Sector's forward view

Economic forecasting remains troublesome with so many external influences weighing on the UK. There does, however, appear to be consensus among analysts that the economy remains weak and whilst there is still a broad range of views as to potential performance, they have all been downgraded throughout 2011. Key areas of uncertainty include:

- a worsening of the Eurozone debt crisis and heightened risk of the breakdown of the bloc or even of the currency itself & the impact of the Eurozone crisis on financial markets and the banking sector;
- the impact of the Government's austerity plan on confidence and growth and the need to rebalance the economy from services to exporting manufactured goods;
- the under-performance of the UK economy which could undermine the Government's policies that have been based upon levels of growth that increasingly seem likely to be undershot;
- a continuation of high levels of inflation ;
- the economic performance of the UK's trading partners, in particular the EU and US, with some analysts suggesting that recession could return to both;

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

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

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

Appendix 3 - Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

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

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 XX/XX/XXXX and will apply its principles to all investment activity. In accordance with the Code, the Director of Finance has produced its Treasury Management Practices (TMPs). This part, TMP 1(5), covering investment counterparty policy requires approval each year.

Annual Investment Strategy - 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 that the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- 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 pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's or Fitch rating agencies.

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

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. 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 minimized as far as is possible.</p>	£10k
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 have a minimum asset size which places them in the top 10 building societies, but will restrict these type of investments to 1 year in length.</p>	£2m for 1 year
e.	<p>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).</p>	<p>Maximum limit of 100% but no more than £12m of investments to have maturities of longer than 1 year at any one</p>

		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 equivalent) as rated by S&P, Moody or Fitch rating agencies	£5m for 365 days

Within categories c and d, and in accordance with the Code, the Council has developed additional criteria to set the overall amount of monies which will be invested in these bodies. 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

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 Director for Resources and Transformation, and if required new counterparties which meet the criteria will be added to the list.

APPENDIX 4 Approved countries for investments

AAA

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

AA+

- Australia
- Belgium
- Hong Kong
- U.S.A.

AA

- Kuwait
- UAE

AA-

- Japan
- Qatar
- Saudi Arabia

APPENDIX 5 Treasury management scheme of delegation

(i) Full Council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

(ii) Executive

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

(iii) Audit Committee

- reviewing the treasury management policy and procedures and making recommendations to the Executive/Full Council.

APPENDIX 6 The treasury management role of the section 151 officer

The S151 (responsible) officer

- 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;
- recommending the appointment of external service providers.