LANCASTER
CITY COUNCIL
Promoting City, Coast & Countryside

LATE REPORTS, URGENT BUSINESS and SUPPLEMENTARY INFORMATION

Cabinet

Tuesday, 16 February 2010

The following reports were received too late to be included on the main agenda for this meeting and were marked 'to follow'. They are now enclosed, as follows:

Agenda Item Number	Page	Title	Reason for Late Report	Officer Responsible For Late Report
13	1 - 21	TREASURY MANAGEMENT STRATEGY 2010/2011	Report not available at time of agenda publication.	Report of the Head of Financial Services
16	22 - 28	SENIOR MANAGEMENT RESTRUCTURE	Report not available at time of agenda publication.	Report of the Chief Executive.

CABINET

TREASURY MANAGEMENT STRATEGY 2010/11
16 February 2010

Report of Head of Financial Services

PURPOSE OF REPORT					
This report sets out the position regarding the 2010/11 to 2012/13 Treasury Management Strategy for Cabinet's approval.					
Key Decision	✓	**Non-Key Decision**		**Referral**	
Date Included in Forward Plan	February 2010				
This report is public.					

RECOMMENDATIONS OF OFFICERS

1. **That Council be recommended to adopt the updated Code of Practice as reflected in *Appendix A*.**

2. **That Council be recommended to approve the Treasury Management Policy Statement as set out at *Appendix B*.**

3. **That Council be recommended to approve the Treasury Management Strategy for the period 2010/11 to 2012/13 as set out in Appendix C, incorporating the Investment Strategy and Treasury Management Indicators, and as updated for Cabinet's final budget proposals.**

1 **INTRODUCTION**

1.1 It is a requirement of the CIPFA Code of Practice on Treasury Management that a strategy outlining the expected treasury activity for the forthcoming 3 years is adopted, but that this be reviewed at least annually. The proposed Treasury Management Strategy for the period 2010/11 to 2012/13 needs to cover the following forecasts and activities:

- the current treasury position
- expected movement in interest rates
- the borrowing and debt strategy
- the investment strategy
- specific limits on treasury activities
- treasury management indicators (previously reported as prudential indicators).

1.2 Further to the difficulties experienced in the Icelandic banking collapse and the wider banking crisis generally, the Code was updated in November 2009 and as a result several specific changes have been made. Also Government has recently consulted on changes to its investment guidance and these also need to be taken into account. That said, the Code and draft investment guidance still remain flexible in order to cater for different public sector organisations and their differing operating arrangements, circumstances and risk appetites. Proposals regarding the various aspects of this authority's treasury management framework are set out below for Cabinet's consideration, although these would need to be updated should there be any changes to Cabinet's final budget proposals. It is not known when the investment guidance will be finalised, but it is not expected that there will be any substantive changes to the current draft. The treasury framework, as updated, will be referred on for approval at Budget Council on 03 March.

2 ADOPTION OF THE UPDATED CODE AND POLICY STATEMENT

2.1 The Code was originally adopted by Council back in 2002. Whilst in essence much of the updated 2009 Code remains the same, there are some changes required to the key principles and supporting requirements and these are reflected in ***Appendix A***; the wording is prescribed in the Code and in essence, the content underpins the rest of the framework proposals as set out in this report. It is therefore recommended that the updated Code be adopted by the Council. In due course, Audit Committee will be recommended to update the Financial Regulations accordingly.

2.2 Similarly, prior to reviewing any detailed proposals regarding the framework for next year, Cabinet also need to consider the Treasury Policy Statement as set out at ***Appendix B,*** for referral on to Council. This has been amended slightly to reflect the updated Code's requirements and will be included in the Council report accordingly.

3 TREASURY MANAGEMENT STRATEGY

3.1 Taking account of the above changes, the proposed Treasury Management Strategy Statement for 2010/11 to 2012/13 is set out at ***Appendix C*** for Cabinet's consideration. This document contains the necessary details to comply with both the Code and investment guidance. Responsibilities for treasury management are set out at ***Appendix D.*** These are broadly unchanged from previous years but are updated to reflect the new Code and that a single document covering the Treasury Management Strategy and the Investment Strategy is to be approved by Council.

3.2 Key elements and assumptions feeding into the proposals are outlined below. These take account of Cabinet's existing budget proposals. Should there be any changes to the budget, then the treasury framework would need to be updated accordingly.

3.3 Borrowing Aspects of the Strategy

3.3.1 Based on the draft budget, the borrowing position of the Council is currently projected to remain constant over the next three years. This however, assumes no impact from compensation claims for Luneside East regeneration and also assumes that the Council will benefit from capital receipts linked to the sale of land at South Lancaster. The position on Iceland is also far from certain; whilst assumptions have been made, as yet the Council's creditor status has yet to be finally determined through the courts.

3.3.2 The above points represent major assumptions and depending on their outcome, the debt strategy may vary greatly from that attached. There is also the potential for significant impact on revenue, through associated increased interest charges/lost investment income and making minimum revenue provisions (MRP) for any additional debt repayment. Cabinet's proposals in respect of the General Fund Capital Programme are most likely to affect this element of the Strategy.

3.4 **Investment Aspects of the Strategy**

3.4.1 The investment strategy for 2009/10 came in the aftermath of the Icelandic banking crisis. This had a direct impact on the Council in terms of frozen investment balances, as well as a broader influence on the treasury management function. Several changes were introduced to reduce counterparty risk in relation to investments, as follows:

- The maximum amount to be invested with any one institution (other than the UK Government) was reduced from £6M to £4M. This limit applies mainly where there is instant access (i.e. not fixed term investments), but with the exception of investments placed with other local authorities or the European Central Bank. Should any other fixed term deposits be considered, a lower limit of £2M applies.

- The lowest common denominator approach to interpreting credit ratings from all 3 agencies was introduced.

- The Strategy included a separate limit of £10M (now proposed to be increased to £20M) specifically for the Government's Debt Management Accounts Deposit Facility (DMADF). This is included as a minimal return 'safe haven'.

- UK institutions were given precedence over other countries, and sovereign ratings (i.e. the credit ratings of countries) were applied. Aside from the UK, only other EU countries were to be used.

- No forward deals were to be entered into.

- No investments were to be made for any period longer than a year.

3.4.2 Although the financial sector has remained relatively stable over the last 12 months, the UK is only just out of recession and it is still facing an unprecedented public sector deficit. Uncertainty in the financial sector still remains. This means that there is no argument for relaxation of the measures taken in the prior year. The only real changes to investment limits for 2010/11 onwards are an increase to the proposed limit with the DMADF and a reduction on the time limits for fixed term deposits to 3 months on upper limit counterparties (see table 4, ***Appendix C***). This reduction reflects the Authority's lack of appetite for the risk associated with longer term deposits; even through the limit was set at 1 year for 2009/10, no fixed term deposits were placed (except with the DMADF).

3.4.3 In line with the updated Treasury Management Code and Investment Guidance though, there are additional elements to be introduced to help manage risk. These include:

- the explicit nomination of Budget and Performance Panel as the scrutiny committee for Treasury Management; and
- an increased frequency of reporting to Members, insofar as a formal mid-year review will be included.

3.4.4 Whilst in essence the requirements of the new Code and guidance do not materially change the Council's existing arrangements, they do seek to clarify responsibilities. In particular, it is crucial that training is provided to help ensure that both Members and Officers have the necessary skills to fulfil their respective responsibilities. This area will continue to feature in the Member Development Plan as well as Officer related training programmes. It will be considered by the Council's Business Committee in due course.

3.4.5 Overall, the strategy put forward follows on from 2009/10 in that it is based on the Council having a low risk appetite, with a focus on highly liquid, high quality deposits. Going forward, the development of benchmarking should help Members in future to set the strategic framework for Treasury Management, allowing for a degree of risk that is judged to be acceptable. At present, given very low interest rates, the opportunity cost attached to a low risk strategy is considered to be low also – but this would change should interest rates start to increase.

3.4.6 It is stressed in terms of treasury activity, there is no risk free option. It is felt, however, that the measures set out above provide a sound framework within which to work over the coming year.

4 CONSULTATION

4.1 Officers have liaised with Butlers, the Council's Treasury Advisors, in developing the proposed Strategies and they have also consulted KPMG LLP as the Council's external auditors. Following the Icelandic difficulties, additional audit work was undertaken regarding the Council's treasury management arrangements. This led to a number of recommendations and Officers have given these due consideration and responded accordingly. Where appropriate, further discussions have taken place. At this stage it is considered that the actions taken (or planned) are reasonable, though clearly progress will be reviewed and reported in future audit work. More information is included at ***Appendix E***.

4.2 The proposals are also to be considered by Budget and Performance Panel at its meeting on 23 February 2010 and any recommendations arising will be fed directly into Budget Council.

5 OPTIONS AND OPTIONS ANALYSIS

5.1 As part of the adoption of the updated CIPFA Code of Practice on Treasury Management it is a statutory requirement that the Authority has a Treasury Management Strategy Statement and Investment Strategy. In this regard, Cabinet may put forward alternative proposals or amendments to the proposed documents, but these would have to be considered in light of legislative, professional and economic factors, and importantly, any alternative views regarding the Council's risk appetite. As such, no further options analysis is available at this time.

5.2 Furthermore, the Strategies must fit with other aspects of Cabinet's budget proposals, such as investment interest estimates and underlying prudential borrowing assumptions, feeding into Prudential and Treasury Management Indicators. It should be noted that the Prudential Indicators will also be covered in the Budget report, elsewhere on this agenda.

6 OFFICER PREFERRED OPTION AND JUSTIFICATION

6.1 The Officer Preferred Options are as reflected in the recommendations to this report. This is based on the Council having a low risk appetite regarding investments, and it takes into account the requirements of the new Code.

RELATIONSHIP TO POLICY FRAMEWORK

This report is in accordance with the Council's Treasury Management Policy, and fit with the development of the Medium Term Financial Strategy.

CONCLUSION OF IMPACT ASSESSMENT
(including Diversity, Human Rights, Community Safety, Sustainability etc)

No direct implications arising.

FINANCIAL IMPLICATIONS

None directly arising. The Strategy is in support of achieving the borrowing cost and investment interest estimates included in the draft base budget, based on a low risk approach.

DEPUTY SECTION 151 OFFICER'S COMMENTS

This report and its content forms part of the S151 Officer's responsibilities.

LEGAL IMPLICATIONS

Legal Services have been consulted and have no observations to make regarding this report; there are no implications directly arising.

MONITORING OFFICER'S COMMENTS

The Monitoring Officer has been consulted and has no further comments.

BACKGROUND PAPERS	**Contact Officer: Nadine Muschamp**
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APPENDIX A

For consideration by Cabinet 16 February 2010

Adoption of the 2009 Code of Practice on Treasury Management:

Treasury Management Clauses to form part of Financial Regulations

Changes are in *italics:*

C1 The authority has adopted the key recommendations of CIPFA's Treasury Management in Public Services: *Code of Practice 2009 (the Code)* as detailed below:

Key Principle 1

Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.

Key Principle 2

Their policies and practices should make clear the effective management and control of risk and prime objectives of their treasury management activities *and that responsibility for these lies clearly within their orgainsations. Their appetite for risk should form part of their annual strategy and should ensure that priority is given to security and yield when investing funds.*

Key Principle 3

They should acknowledge that the pursuit of *value for money* in treasury management, and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this.

C2 Accordingly, the Authority will create and maintain, as cornerstones for effective treasury management:

- a treasury management policy statement, stating the policies and objectives *and approach to risk management* of its treasury management activities;
- suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

C3 Full Council will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, *a mid-year review* and an annual report after its close, in the form prescribed in its TMPs.

C4 The Authority delegates responsibility for the implementation and monitoring of its treasury management policies and practices to the Cabinet (through the Council's Performance Management Framework), and for the execution and administration of treasury management decisions to the Section 151 Officer, who will act in accordance with the Council's policy statement and TMPs and, if they are a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

C5 The Authority designates Budget and Performance Panel to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

APPENDIX B

LANCASTER CITY COUNCIL

TREASURY MANAGEMENT POLICY STATEMENT

For consideration by Cabinet 16 February 2010

This has been updated to reflect the revised CIPFA Treasury Management Code of Practice (November 2009). Changes are in *italics*.

1. This organisation defines its treasury management activities as:

   "The management of the 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".

2. This organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

3. This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving *value for money* in treasury management, and to employing suitable *comprehensive* performance measurement techniques, within the context of effective risk management.

Note: The current policy reads "... achieving *best value* in treasury management, and to employing suitable performance measurement ...".

APPENDIX C

Treasury Management Strategy 2010/11 to 2012/13

Draft for Consideration by Cabinet 16 February 2010

Introduction

1. The treasury management function is an important part of the overall financial management of the Council's affairs. Its importance has increased as a result of the freedoms provided by the Prudential Code. Whilst the prudential indicators consider the affordability and impact of capital expenditure decisions, the treasury function covers the effective funding of these decisions. There are also specific treasury indicators included in this strategy that need approval.
2. The Council's activities are strictly regulated by statutory requirements and a professional code of practice (i.e. the CIPFA Code of Practice on Treasury Management, revised November 2009: the "Code"). This Council originally adopted the Code on 13 February 2002, and will now adopt the revised Code. In doing so, it will also adopt an updated treasury management policy statement.
3. The Code requires an annual strategy to be reported to Council outlining the expected treasury activity for the forthcoming 3 years. A further report is produced after the year-end to report on actual activity for the year. As a consequence of the revised Code, a mid year monitoring report will now also be produced for Council.
4. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury function.
5. This strategy therefore covers:
    - the current treasury position;
    - expected movement in interest rates;
    - the Council's borrowing and debt strategy (including its policy on making provision for the repayment of debt);
    - the Council's Investment Strategy;
    - specific limits on treasury activities;
    - treasury management indicators; and
    - specific sections on training and the use of consultants.

    This strategy document contains the relevant information to comply with both the Code and the draft updated Investment Guidance issued by Government. The sections that specifically satisfy requirements of the Investment Guidance are: specified and non specified investments (33-42), credit risk assessment (34-39), use of investment consultants (52-53), training (54), borrowing in advance of need (10) and length of deposits (40-44).

Treasury Position

6. The forecast treasury position and the expected movement in debt and investment levels over the next three years are as follows.

Table 1: Gross external debt and investment forecast

	2010/11 Estimated	2011/12 Estimated	2012/13 Estimated
	£'000	**£'000**	**£'000**
EXTERNAL DEBT			
Borrowing	**39,200**	**39,200**	**39,200**
Other long term liabilities	**260**	**255**	**250**
Total Debt at 31 March	**39,460**	**39,455**	**39,450**
INVESTMENTS			
Total Investments at 31 March	**8,800**	**8,800**	**8,800**
Total investment adjusted for Iceland 31 March*	**3,640**	**4,810**	**5,730**
Projected average investment balances*	**10,240**	**11,060**	**11,910**

*cash balances projected assuming non priority creditor status for Glitnir

7. The forecast position on external borrowing remains static across the three years, despite the fact that by the end of 2009/10 the Council's Capital Financing Requirement (CFR: i.e. the underlying need to borrow) is projected to be well in excess of gross long term borrowings. The twin issues of the amounts set aside for the future repayment of debt, and a cashflow position which is forecast to remain relatively stable, mean that there is no immediate need to take out new loans.

8. The revenue consequences of these balances, namely investment income and borrowing costs (and the relevant recharges between the HRA), are included within the overall revenue budget.

9. The projected average investment balances indicate the difference between the gross and the net borrowing position. This is projected to be lower than in prior years due to the repayment of PWLB loans in January 2009 (£5.6M) and the potential loss of principal from Icelandic banks.

10. Although the Council holds both investment balances and long terms borrowings, this is not a result of borrowing in advance of need or to on-lend. The Council's external borrowings provide the cash to help pay for a proportion of the Council's ongoing and accumulated capital spend (the CFR). Separate to this the Council is required to hold a certain amount of balances, provisions and other items to ensure that resources are available when needed; these are generally cash backed. Flexibility is allowed on utilising these cash funds in lieu of borrowing, which the Council is doing in part.

Scenario Review

11. The position above assumes that there will be no pressure to physically borrow to support the capital programme over the next three years, although it does assume that cash balances will be reduced due to Icelandic impairments, including having no priority creditor status for Glitnir. This is equivalent to scenario 2 below. However, there are two large elements that could lead to a change in this position. These are the potential impact of Luneside East compensation claims and the potential failure to achieve capital receipts for sale of land at South Lancaster. The potential incremental effect of these over the period 2009/10 to 2012/13 on the Council's borrowing requirement and its need to make provision for repayment in its revenue budget (MRP: Minimum Revenue Provision) can be seen overleaf:

Table 2 Debt scenarios for the period 2009/10 to 2012/13

	Borrowing requirement over period	Total MRP over a 4 year period	Projected movement in CFR over period
	£'000	**£'000**	**£'000**
Scenario 1, "best case"	**-1,505**	**5,414**	**-6,919**
Scenario 2, Icelandic impairment required	**542**	**5,660**	**-5,118**
Scenario 3, Iceland impairment and additional Luneside costs	**5,042**	**6,020**	**-978**
Scenario 4, Worst case; Iceland, Luneside East and South Lancaster	**12,542**	**6,320**	**6,222**

12. From the table above is it clear that the effect of Luneside East and capital receipts from sale of land at South Lancaster could have a large impact on the Council's CFR and its potential debt position, as well as the annual revenue provision that will have to be set aside, irrespective whether physical borrowing is taken out or not.

13. It is important to note that any increase in CFR does not necessarily lead to an increase in physical borrowing. Should physical borrowings not be required, this would be due to internal cash being applied instead, as outlined in paragraph 10. In the current climate, where investment returns are well below the cost of borrowing, this would be the preferred option. Where there is an increase in CFR however, there would be either be a real interest charge arising should new borrowing be taken out, or a loss of investment income should existing cash balances be used to support the capital expenditure.

Expected Movement in Interest Rates

Table 3: Medium-Term Rate Estimates (averages)

Annual Average %	Bank Rate	Money Rates		PWLB Rates*		
		3 month	1 year	5 year	20 year	50 year
2008/09	3.9	5.0	5.3	4.2	4.8	4.5
2009/10	0.5	0.8	1.4	3.2	4.4	4.6
2010/11	1.0	1.5	2.3	4.0	5.0	5.2
2011/12	2.0	2.5	3.3	4.3	5.3	5.3
2012/13	4.5	4.8	5.3	5.3	5.5	5.3

* Borrowing Rates

Information provided by Butlers Consultants January 2010:

14. Short-term rates are expected to remain on hold for a considerable time. The recovery in the economy has commenced but it will remain insipid and there is a danger that early reversal of monetary ease, (rate cuts and Quantative Easing (QE)), could trigger a dip back to negative growth and a W-shaped Gross Domestic Product (GDP) path.

15. Credit extension to the corporate and personal sectors has improved modestly but banks remain nervous about the viability of counterparties. This is likely to remain a drag upon activity prospects, as will the lacklustre growth of broad money supply.

16. The main drag upon the economy is expected to be weak consumers' expenditure growth. The combination of the desire to reduce the level of personal debt and job uncertainty is likely to weigh heavily upon spending. This will be amplified by the prospective increases in taxation already scheduled for 2010 – VAT and National Insurance. Without a rebound

in this key element of UK GDP growth, any recovery in the economy is set to be weak and protracted.

17. The Monetary Policy Committee (MPC) will continue to promote easy credit conditions via quantitative monetary measures. QE has been extended to a total of £200BN. Whether this has much impact in the near term remains a moot point given the personal sector's reluctance to take on more debt and add to its already unhealthy balance sheet.
18. With inflation set to remain subdued in the next few years (though a sharp blip is forecast for the next few months), the pressure upon the MPC to hike rates will remain moderate. But some increase will be seen as necessary in 2010 to counter the effects of external cost pressures (as commodity price strength filters through) and to avoid damage that sterling could endure if the UK is seen to defy an international move to commence policy exit strategies.
19. The outlook for long-term fixed interest rates is a lot less favourable. Whilst the UK's fiscal burden should ease in the future, this will be a lengthy process and deficits over the next two to three financial years will require a very heavy programme of gilt issuance. The market will no longer be able to rely upon Quantitative Easing to alleviate this enormous burden.
20. The programme was not extended in February. With growth back on the agenda and inflation challenging the upper limit of the Government's target range, going forward, the majority of MPC members may feel enough assistance has been given to ensure lack of credit is no longer a fundamental threat to the welfare of the economy.
21. 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.
22. This incentive will take the form of higher interest rates. The longer fixed interest rates 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. The shorter fixed interest rates will be pressured higher by the impact of rising money market rates. While bank purchases in this part of the market will continue to feature as these institutions meet regulatory obligations, this process will be insufficiently strong to resist the upward trend in yields.

Borrowing and Debt Strategy 2010/11 to 2012/13

23. 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. As outlined in the scenarios section above, there are also a number of other factors outside of the Council's direct control, which could have a significant impact on its need to borrow. As these issues are clarified, the options around borrowing will be considered in relation to the longer term prospects of rate rises.
24. 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 Head of Financial Services, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, if need be, taking into account the risks shown in the forecast above. It is likely that shorter term fixed rates may provide lower cost opportunities in the short to medium term.
25. With the likelihood of long term rates increasing, debt restructuring is likely to focus on switching from longer term fixed rates to cheaper shorter term debt, although the Head of Financial Services and treasury consultants will monitor prevailing rates for any opportunities during the year.
26. The option of postponing borrowing and running down investment balances will also be considered, this would have the added benefit of further reducing counterparty risk.

Provision for the Repayment of Debt 2010/11 to 2012/13

27. Up until 2007/08 the Council calculated the basic amount of provision, which it sets aside each year from revenue for the repayment of debt, in accordance with a prescribed formula based on the CFR. To this was added a further provision in respect of the financing of assets with relatively short lives, as considered prudent.

28. The new arrangements were introduced from 1 April 2008. In summary:

    - the prescribed formula has been abolished and replaced by a simple requirement for Councils to make ‘prudent’ provision;
    - the old calculation may still be used for relevant capital expenditure before 31 March 2008, but
    - provision relating to relevant capital expenditure after this date must either be based on the estimated life of the asset, or equal to the depreciation on the asset.

29. The new arrangements also included reference to ‘supported’ or unsupported’ capital expenditure:

    - ‘Supported’ is the amount of capital expenditure for which the authority has received revenue support from Government to help meet the financing costs. (i.e. for credit / borrowing – it excludes grant financing).
    - ‘Unsupported’ is where the authority receives no such revenue assistance (often also referred to as prudential borrowing).

30. Financially, the new arrangements for calculating the Minimum Revenue Provision (MRP) has no real impact on the Council because the changes effectively codify the full ‘prudent’ provision which the Council was already making. Nonetheless, as an element of discretion has been introduced the Council’s approach must be formalised within the borrowing strategy.

31. Therefore, for 2010/11, the Council’s policy for the making of provision for the repayment of debt will be as follows:

    - For all relevant capital expenditure prior to 1 April 2008, with the exception of that in respect of motor vehicles (i.e. less than 15 years life), by the application of the former prescribed formula *(i.e. for General Fund, 4% of the non-housing related Capital Financing Requirement at the start of the year)*.
    - For capital expenditure on motor vehicles prior to 01 April 2008, and for all supported or unsupported capital expenditure on or after that date, equal annual amounts based on the estimated life of each individual asset so financed, as is consistent with the revised Minimum Revenue Provision guidance (February 2008, method 3).

Investment Strategy 2010/11 to 2012/13

32. The primary objective of the Council’s investment strategy is to safeguard the re-payment of the principal and interest of its investments, with ensuring adequate liquidity being the second objective, and achieving investment returns being the third.

33. The types of investment allowable are categorised as either Specified and Non Specified investments. Details of these are set out in ***Appendix C1***.

34. Following the economic background described above, the current investment climate has one over-riding risk consideration, that of counterparty security risk. As a result of these underlying concerns, Officers are currently implementing an operational investment strategy which tightens the controls already in place. The Head of Financial Services will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. The use of these criteria provides an overall pool of counterparties that are considered as high quality and that may be chosen for investment, subject to other considerations.

35. 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 of the lending criteria. This complies with a CIPFA Treasury Management Panel recommendation in March 2009 and the actual Code.

36. Credit rating information is supplied by the Council's treasury consultants (Butlers) 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. More information on credit ratings is included in ***Appendix C2***.

37. The criteria for providing a pool of high credit quality investment counterparties (for both specified and non-specified investments) are:

- **Banks 1 - Good Credit Quality**

  The Council will only use banks that:

  a) are UK banks; or
  b) are non-UK but are domiciled in an EU country with a long term sovereignty rating of AAA,

  and have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated, as is consistent with the middle limit as per table 4):

  i. **Short Term:** F1/P-1/A-1

  ii. **Long Term:** A/A2/A

  iii. **Individual / Financial Strength:** C (Fitch / Moody's only)

  iv. **Support:** 3 (Fitch only)

- **Banks 2 – Guaranteed Banks with suitable Sovereign Support**

  In addition, the Council will use EU 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 & Poors); 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 is an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008, with the necessary short and long term ratings required in *Banks 1* above. These institutions have been subject to suitability checks before inclusion, and have access to HM Treasury liquidity if needed.

- **Banks 4 – The Council's own Banker**

  The bank may be used 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.

- **Building Societies –** all Societies that meet the ratings for banks outlined above.

- **Money Market Funds –** AAA-rated sterling funds with constant unit value.

- **UK Government –** Debt Management Account Deposit Facility (DMADF)

- **Local Authorities (including Police and Fire Authorities), Parish Councils**
- **Supranational institutions** (e.g. European Central Bank)

38. 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 25% will be placed with any one non-UK country at any time;
- limits in place above will apply to Group companies;
- Sector limits will be monitored.

39. The updated Code of Practice and draft Investment Guidance now require the Council to supplement credit rating information. Whilst the Council's strategy 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 (e.g. credit default swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

40. For the above categories of Specified and Non Specified Investments, and in accordance with the Code, the Council has developed additional criteria to set the maximum amounts that may be invested in these bodies. The criteria, using the lowest common denominator approach are set out below.

Table 4: Counterparty Criteria and Investment Limits

	Minimum across all three ratings			Money Limit[7]	Time Limiit[8]
	Fitch	Moody's	Standard & Poors		
Upper Limit[1]	F1+/AA-	P-1/AA3	A-1+/AA-	£4M	Instant access only
				£2M	3 months
Middle Limit[2]	F1/A	P-1/A2	A-1/A	£2M	Instant access only
Other Institutions[3]	N/A	N/A	N/A	£4M	1 Year
Money Market Funds[4]	AAA	AAA	AAA	£4M	Instant Access Only
DMADF deposit[5]	N/A	N/A	N/A	£20M	1 Year
Sovereign rating to apply to all non UK counterparties[6]	AAA	AAA	AAA	N/A	N/A

Notes:
1 & 2: The Upper and Middle Limits apply to appropriately rated banks and building societies.
3: The Other Institutions limit applies to other local authorities and supranational institutions (i.e. ECB).
4: Sterling, constant net asset value funds only.
5: The DMADF facility is direct with the UK government, it is extremely low risk and hence the higher limit.
6: UK investments are defined as those listed under UK banks or building societies in the Butler's counterparty listing.
7: Money limits apply to principal invested and do not include accrued interest.
8: Time Limits start on the trade date for the investment.

41. In the normal course of the Authority'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. The Council will maintain a minimum £2M of investments in Specified Investments provided that the cashflow allows for this. In

addition, although the Council will consider using non specified investments (as described in append C1), these should not exceed 50% of the portfolio at any one time. The limits applied will be consistent with the short and long term ratings in table 4 above.

42. The use of longer term instruments (greater than one year from trade date to maturity) and forward deals will not be used.

43. Expectations on shorter-term interest rates, on which investment decisions are based, show a likelihood of the current 0.5% Bank Rate remaining flat but with the possibility of a rise in mid-2010. The Council's investment decisions are based on comparisons between the rises priced into market rates against the Council's and advisers own forecasts.

44. There is some operational difficulty arising from the current banking crisis, albeit that there is currently little value investing longer term and credit risk remains uncertain. Whilst some selective options do provide additional yield, uncertainty over counterparty creditworthiness indicates that shorter dated investments provide better security. As such, the time limit for upper limit investments has been further reduced to 3 months with middle limit institutions only being used for instant access.

45. The criteria for choosing counterparties set out above provide a sound approach to investment in "normal" market circumstances. Whilst Members are asked to approve the base criteria above, under the exceptional current market conditions the Head of Financial Services may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval. These restrictions will remain in place until the banking system returns to "normal" conditions. Similarly the time periods for investments will be restricted.

46. Examples of these restrictions include greater use of the Debt Management Deposit Account Facility (DMADF – a Government body which accepts local authority deposits), guaranteed deposit facilities and strongly rated institutions offered support by the UK Government as appropriate. The credit criteria reflect these facilities.

Risk benchmarking

47. A development in the revised Code and in Government consultation 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 for Member reporting, although the application of these is more subjective in nature. The purposes of the benchmarks are to aid Officer monitoring of the current and trend positions and to inform any amendments to the operational strategy and actions required, depending on any changes.

48. At present, the criteria set down in table 4 above and through the treasury management indicators below, limit activity in terms of length of deposit (liquidity) and in terms of strength of the counterparty (security). The current strategy follows on from the 2009/10 strategy in being low risk through, for example, restricting the amount and length of deposit in any one counterparty as well as mandating high liquidity on larger deposits. The use of benchmarking should allow the Council to set strategic parameters on investments that allow for an 'acceptable' level of risk in the portfolio, as set down by Members. The Council's treasury consultants, Butlers, have provided a method for quantifying the security and liquidity of the portfolio and this is currently under review. Detailed proposals will be included in subsequent reports to Members.

Treasury Management Indicators and Limits on Activity

49. There are four mandatory treasury management Indicators. The purpose of these indicators is 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. The full list of Prudential Indicators is included elsewhere on the agenda, but the treasury management indicators are as follows:

- Upper limits on fixed interest rate exposure – This indicator identifies a maximum limit for fixed interest rates based upon the debt position net of investments.
- Upper limits on variable interest rate exposure – Similar to the previous indicator, this covers a maximum limit on variable 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 – given the current economic climate the Authority is not willing to risk investing sums for fixed terms of greater than 1 year and so this is £0.

50. Council will also be requested to approve the treasury management indicators, as updated in line with final budget proposals, at its meeting on 03 March 2010.

Table 5: Treasury Management Indicators

	2010/11		2011/12		2012/13	
Interest Rate Exposures						
	Upper		**Upper**		**Upper**	
Limits on exposure to fixed interest rates	100%		100%		100%	
Limits on exposure to variable interest rates	30%		30%		30%	
Maturity Structure of fixed interest rate borrowing						
	Lower	**Upper**	**Lower**	**Upper**	**Lower**	**Upper**
Under 12 months	0%	35%	0%	35%	0%	35%
12 months to 2 years	0%	20%	0%	20%	0%	20%
2 years to 5 years	0%	20%	0%	20%	0%	20%
5 years to 10 years	0%	20%	0%	20%	0%	20%
10 years to 15 years	0%	50%	0%	100%	0%	100%
15 years to 25 years	0%	100%	0%	100%	0%	100%
25 years to 50 years	50%	100%	50%	100%	50%	100%
Actual current position						
Under 12 months	0%		0%		0%	
12 months to 2 years	0%		0%		0%	
2 years to 5 years	0%		0%		0%	
5 years to 10 years	0%		0%		0%	
10 years to 15 years	0%		0%		0%	
15 years to 25 years	0%		0%		0%	
25 years to 50 years	100%		100%		100%	
Maximum principal sums invested > 364 days						
Principal sums invested, in 2010/11, for periods of greater than 364 days, to mature after the end of each financial year	£0M		£0M		£0M	

Performance Indicators

51. 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 that are predominantly forward looking. Examples of performance indicators often used for the treasury function are:

- Debt – Average rate movement year on year
- Investments – Internal returns above the 7 day LIBID rate

The results of these indicators will be reported in the Treasury Annual Report and the mid-year report as required under the new Code.

Treasury Management Advisers

52. The Council currently uses Butlers as its treasury management consultants. The company provides a range of services that 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;
53. 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

54. 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 addresses this important issue by providing Member training in liaison with its treasury advisors and through ongoing training and supervision of officers involved the day to day operation of the treasury function.

APPENDIX C1

Definitions of Specified and Non Specified Investments

See the detailed Investment Strategy included in Appendix C, for the limits to be applied.

1. Specified Investments are defined as follows.

SPECIFIED INVESTMENTS

These are to be sterling investments of a maturity period of not more than 364 days, or those which could be for a longer period but where the Council has the right to be repaid within 364 days if it wishes. These are low risk assets where the possibility of loss of principal or investment income is considered negligible. These include investments with:

(i) The UK Government (such as the Debt Management Office, UK Treasury Bills or a Gilt with less than one year to maturity).

(ii Supranational bonds of less than one year's duration.

(iii) A local authority, parish council or community council.

(iv) An investment scheme that has been awarded a high credit rating by a credit rating agency (although this definition is changing in the draft CLG Investment Guidance to "High Credit Quality").

(v) A body that has been awarded a high credit rating by a credit rating agency (such as a bank or building society).

For category (iv) this covers a money market fund rated by Standard and Poor's, Moody's or Fitch rating agencies.

2. Non-specified Investments are defined as follows:

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 are set out below.

Ref	Non Specified Investment Category	Limit
(i)	A body which has been provided with a government issued guarantee for wholesale deposits within specific timeframes. Where these guarantees are in place and the government has an AAA sovereign long term rating these institutions will be included within the Council's criteria temporarily until such time as the ratings improve or the guarantees are withdrawn. Monies will only be deposited within the timeframe of the guarantee.	Included as per Appendix C
(ii)	A body which is an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008.	Included as per Appendix C
(iii)	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.	Included as per Appendix C

APPENDIX C2

Background information on credit ratings

Credit ratings are a key part of the Authority's investment strategy. The information below summarises some of the key features of credit ratings and why they are important.

What is a Credit Rating ?

A credit rating is:
- An independent assessment of an organisation;
- It gauges the likelihood of getting money back on the terms it was invested;
- It is a statement of opinion, not statement of fact;
- They help to measure the risk associated with investing with a counterparty;

Who Provides / Uses Credit Ratings?

There are three main ratings agencies, all of which are used in the Authority's treasury strategy.
- Fitch
- Moody's Investor Services
- Standard & Poors

The ratings supplied by these agencies are used by a broad range of institutions to help with investment decisions, these include:

- Local Authorities;
- Other non-financial institutional investors;
- Financial institutions;
- Regulators;
- Central Banks;

Rating Criteria

There are many different types of rating supplied by the agencies. The key ones used by the Authority are ratings to indicate the likelihood of getting money back on terms invested. These can be split into two main categories:

- 'Short Term' ratings for time horizons of 12 months or less. These may be considered as the most important for local authorities.

- 'Long Term' ratings for time horizons of over 12 months. These may be considered as less important in the current climate.

In addition, the agencies issue sovereign, individual and support ratings which will also feed into the investment strategy.

Rating Scales (Fitch, Moody's and Standard & Poors)

The table below shows how some of the higher graded short and long term ratings compare across the agencies; the top line represents the highest grade possible. (There are other ratings that go much lower than those shown below, and ratings for other elements.)

Short Term			**Long Term**		
Fitch	Moody's	S&P	Fitch	Moody's	S&P
F1+	P-1	A-1+	AAA	Aaa	AAA
F1	P-1	A-1	AA	Aa2	AA
F2	P-2	A-2	A	A2	A

APPENDIX D

TREASURY MANAGEMENT FRAMEWORK DOCUMENTS AND RESPONSIBILITIES

For Consideration by Cabinet 16 February 2010

DOCUMENT	RESPONSIBILITY
CODE of PRACTICE	To be adopted by Council (originally adopted in 2002 - now updated).
POLICY STATEMENT	The Code of Practice recommends a specific form of words to be used, to set out the Council's objectives within the Policy Statement for its Treasury Management activities. It is the responsibility of Council to approve this document, and then note it each year thereafter if unchanged. This has been updated in line with the revised code November 2009.
TREASURY MANAGEMENT STRATEGY	The Strategy document breaks down the Policy Statement into detailed activities and sets out the objectives and expected market forecasts for the coming year. This also contains all the elements of an Investment Strategy as set out in the DCLG guidance; it is the responsibility of Council to approve this document, following referral from Cabinet.
TREASURY MANAGEMENT INDICATORS	These are included within the Strategy Statement as part of the framework within which treasury activities will be undertaken. It is the responsibility of Council to approve these limits.
INVESTMENT STRATEGY	The Investment Strategy is included within the Treasury Management Strategy. It states which types of investments the Council may use for the prudent management of its treasury balances during the financial year. Under existing guidance the Secretary of State recommends that the Strategy should be approved by Council.
TREASURY MANAGEMENT PRACTICES	These are documents that set out the procedures that are in place for the Treasury Management function within the Council. The main principles were approved by Cabinet following the adoption of the Code of Practice; they include: *TMP 1:* Risk management *TMP 2:* Performance measurement *TMP 3:* Decision-making and analysis *TMP 4:* Approved instruments, methods & techniques *TMP 5:* Organisation, clarity and segregation of responsibilities, and dealing arrangememts. *TMP 6:* Reporting requirements & management information requirements *TMP 7:* Budgeting, accounting & audit *TMP 8:* Cash & cash flow management *TMP 9:* Money laundering *TMP 10:* Staff training & qualifications *TMP 11:* Use of external service providers *TMP 12:* Corporate governance Any changes to the above principles will require Cabinet approval. It is the Head of Financial Service's responsibility to maintain detailed working documents and to ensure their compliance with the main principles. It is highlighted that for 2010/11, quarterly treasury management reports will continue to be included within Corporate Financial Monitoring and in turn, these will be reported into Cabinet and Budget and Performance Panel.

APPENDIX E

Recommendations Arising from Audit Work on Treasury Management, as mandated by the Audit Commission

- Internal Audit should undertake a comprehensive review of the treasury management function and its activities on an annual basis and should report its findings to the Audit Committee;
- All staff involved in undertaking treasury management activities and elected members with responsibility for the stewardship of public money and scrutiny of the treasury management function should undertake ongoing training to ensure they can effectively discharge their responsibilities;
- The Council should consider its arrangements for scrutiny of the whole treasury management process and over its individual investment decisions, ensuring that they are informed; and
- The Council should strengthen its investment criteria by considering wider economic conditions/factors and other information sources, such as the financial press, in addition to strong credit ratings (with the minimum credit rating being AA) when placing investments. This would minimise the risk of investing in institutions with financial difficulties.

Officer Responses:

1. Arrangements are in hand for an Internal Audit review to be undertaken early in the new year, once the new framework is in place under the new Code. This would be reported to Audit Committee as a matter of course. Thereafter, the approach for regular reviews will be agreed between Internal and external audit, taking account of risk considerations.

2. Ongoing training is provided and this is reflected in the draft Strategy. More frequent Member training will be provided in future, but perhaps more significantly, consideration of whether such training should be mandatory will be referred to the Council's Business Committee, as part of the Member Development Plan.

3. Budget and Performance Panel already has responsibility but this will now be more explicit, under the current proposals. The effectiveness of these arrangements will be informed by recommendation 2 above.

4. This is catered for within the proposed strategy, although it has not been possible to incorporate only AA institutions and still maintain a workable UK counterparty listing. After due consideration and consultation, the proposed strategy is based on A rated listings, but with reference to other information sources, such as credit default swap rates, sovereign ratings, and importantly time and money limits. This is considered to be a reasonable approach overall, in managing risk and considering liquidity and return. It is also emphasised that the counterparty list represents only a pool from which to identify potential organisations with which to invest, before taking account of other factors.

By virtue of paragraph(s) 1, 2 of Part 1 of Schedule 12A
of the Local Government Act 1972.

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