COUNCIL

Treasury Management Framework 2013/14
27 February 2013

Report of Cabinet

PURPOSE OF REPORT
This report seeks approval for the Council's treasury management framework for 2013/14 onwards, including all the various elements as required under relevant legislation and the Code of Practice.
This report is public.

RECOMMENDATIONS

1) That Council approves the Treasury Management Framework and associated Prudential Indicators for the period 2013/14 to 2015/16 as set out in Appendices A to C.

1 INTRODUCTION

1.1 The CIPFA Code of Practice on Treasury Management ("the Code") requires that a strategy outlining the expected treasury activity for the forthcoming 3 years be adopted, but that it be reviewed at least annually. It needs to reflect treasury policy and cover various forecasts and activities to integrate the Council's spending and income plans with decisions about investing and borrowing.

1.2 Responsibilities associated with the Code's requirements are set out at ***Appendix A***. Those aspects that require consideration by Council are covered in the following sections.

2 TREASURY MANAGEMENT POLICY STATEMENT

2.1 The Code requires the Council to set out a Policy Statement outlining the definition and objectives of its treasury management activities. The Code requires a specific form of words for the Policy Statement; this is unchanged from the current policy and it is set out at ***Appendix B***.

3 TREASURY MANAGEMENT STRATEGY

3.1 The proposed Strategy for 2013/14 to 2015/16 is set out at ***Appendix C.*** This document contains the necessary details to comply with both the Code and Government investment guidance.

3.2 Key elements and assumptions feeding into the Strategy are outlined below. These fit with Cabinet's budget proposals.

3.3 **Borrowing Aspects of the Strategy**

3.3.1 Based on the draft budget, for now the physical borrowing position of the Council is projected to remain fairly constant over the next three years for the General Fund capital programme, allowing for scheduled repayments. It is also projected that the Council Housing capital programme will not require any additional borrowing.

3.3.2 This position is based on:

- land at south Lancaster being sold in 2013/14;
- the withdrawal from Lancaster Indoor Market and capital growth in connection with corporate property improvements being managed within projected cash resources over the period.

3.3.3 The above points represent major assumptions and depending on their outcome, the debt strategy may need to be varied greatly. If so, Member approval would be sought where appropriate.

3.4 **Investment Aspects of the Strategy**

3.4.1 2012/13 has been dominated by a sovereign debt crisis, which has had a negative impact on the Euro zone as well as the UK economy, including widespread downgrading of banks. This means that there is no strong argument for a significant relaxation of the measures taken post Iceland as counterparty strength is still a major risk. There is the need, however, to ensure sufficient flexibility in managing investments without undermining security, and to ensure that risk appetite is appropriate.

3.4.2 Accordingly, the main changes to investment limits for 2013/14 onwards are:

- Ensuring that sufficient flexibility exists for using part-nationalised banks.
- Allowing for a degree of flexibility so that if a need is determined then the Council may enter in to a cash backed Mortgage Guarantee scheme, linked to its housing regeneration plans.

3.4.3 Overall, the strategy put forward follows on from 2012/13 in that it is based on the Council having a low risk appetite with focus on high quality deposits.

3.4.4 There is a cost linked to a very low risk strategy as instant access accounts with good quality counterparties have relatively low yields. Markets are starting to offer significantly improved rates for longer term deposits with rates of 1.10% for a 12 month deposit. This is in comparison to 0.54% being the average return for the Council's balances overall. To illustrate, placing a £6M deposit for 1 year would have a marginal yield of £41K above that for the Council 'average' investment. A reasonable balance needs to be made.

4 **MID YEAR REVIEW**

4.1 In accordance with the existing strategy, Council must receive a mid-year progress report on treasury activities. Given that Cabinet has recently considered the Quarter 3 treasury management report this is now presented to Council as the mid-year review (rather than the older Quarter 2 report). It is attached at ***Appendix D.***

5 CONSULTATION

5.1 Officers have liaised with Sector, the Council's Treasury Advisors, in developing the proposed framework. The approved framework is also due to be considered by Budget and Performance Panel at its meeting on 05 March 2013, to help inform its future work programme.

6 OPTIONS AND OPTIONS ANALYSIS

6.1 Council may put forward alternative proposals or amendments to the proposed Strategy in ***Appendix C***, 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.

6.2 Furthermore the Strategy must fit with other aspects of the budget, such as investment interest estimates and underlying prudential borrowing assumptions, feeding into Prudential and Treasury Management Indicators.

7 CONCLUSION

7.1 Over the coming months, key transactions should be completed and this will give a much clearer picture of the Council's cashflow and in turn this will assist greatly in actioning the proposed treasury strategy.

RELATIONSHIP TO POLICY FRAMEWORK
This report seeks minor changes to the Council's Treasury Management Policy, and fits with the proposed Medium Term Financial Strategy.

CONCLUSION OF IMPACT ASSESSMENT
(including Diversity, Human Rights, Community Safety, Sustainability etc)
No direct implications arising.

FINANCIAL IMPLICATIONS
The Strategy is in support of achieving the borrowing cost and investment interest estimates included in the budget.

SECTION 151 OFFICER'S COMMENTS
Treasury management forms part of the s151 Officer's responsibilities and she has no further comments to make regarding the proposals.

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

MONITORING OFFICER'S COMMENTS
The Monitoring Officer has been consulted and has no further comments.

BACKGROUND PAPERS Treasury Management in the Public Services. CIPFA Code of Practice and Cross-sector Guidance Notes (2011)	**Contact Officer: Nadine Muschamp** **Telephone:01524 582117** **E-mail:nmuschamp@lancaster.gov.uk**

Appendix A

TREASURY MANAGEMENT FRAMEWORK DOCUMENTS AND RESPONSIBILITIES

For Consideration by Council 27 February 2013

DOCUMENT	RESPONSIBILITY
CODE of PRACTICE	To be adopted by Council (as updated 2011).
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 reflects the revised code November 2011.
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 Government 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 initial 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 Resources' responsibility to maintain detailed working documents and to ensure their compliance with the main principles. Quarterly treasury management reports will continue to be reported through to Members.

Appendix B

LANCASTER CITY COUNCIL
TREASURY MANAGEMENT POLICY STATEMENT

For noting by Council 27 February 2013

This reflects the revised CIPFA Treasury Management Code of Practice (Code updated in 2011).

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 and any financial instruments entered into to manage these risks.

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.

Appendix C

Treasury Management Strategy 2013/14 to 2015/16

For Consideration by Council 27 February 2013

1 Introduction

1.1 Background

The Council is required to operate a balanced budget, which broadly means that cash to be raised during the year will meet cash expenditure, after allowing for any changes in reserves and balances. 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.

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 polices, estimates and actuals.

Prudential and treasury indicators and treasury strategy (this report)

The first and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A mid year treasury management report

This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision. In addition, quarterly reports will continue to be presented to Cabinet with the mid year review being forwarded to Council.

An annual treasury report

This is prepared after the end of the financial year and 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 2013/14

The strategy for 2013/14 covers two main areas:

Capital issues

- the capital plans and the prudential indicators;
- the minimum revenue provision (MRP) strategy.

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- 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 Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code, Government MRP guidance, the CIPFA Treasury Management Code and Government investment guidance.

1.4 Training

The CIPFA Code requires the Head of Resources to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsibe for scrutiny. The training needs of treasury management officers must also be reviewed periodically.

The increased Member consideration of treasury management matters and the need to ensure officers' knowledge and skills are kept up to date requires a suitable training process. 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.

2 The Capital Prudential Indicators 2013/14 – 2015/16

The Council's capital expenditure plans are the key driver of treasury management activity. The detail of capital expenditure plans are reflected in prudential indicators, which aim to give an overview.

2.1 Capital Expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

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

Capital expenditure £'000	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
General Fund	3,826	5,698	5,133	4,578	3,902
HRA	3,574	3,892	4,827	4,621	4,707
Total	**7,400**	**9,590**	**9,960**	**9,199**	**8,609**
Financed by:					
Capital receipts		618	9,443		
Capital grants (general)	100	105	48		
Capital reserves	647	989	487	70	194
Revenue	484	306	30	30	30
Capital grants (specific)	1,262	1,226	1,245	1,229	909
HRA:					
Capital Receipts	759	43	43	44	45
Capital Grants (general)	90				
Capital Reserves	2,453	3,559	4,784	4,577	4,662
Revenue	1,035	290			
Capital grants (specific)	10				
Net financing need for the year	**559**	**2,454**	**(6,120)**	**3,249**	**2,769**

*The relatively large capital receipt relates to the sale of land in south Lancaster

2.2 The Council's Borrowing Need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

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

The CFR includes any other long term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has around £6M of such schemes within the CFR.

£'000	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Capital Financing Requirement					
CFR – General Fund	36,644	37,447	29,821	31,993	33,606
CFR – HRA	46,544	45,503	44,461	43,420	42,379
Total CFR	**83,188**	**82,950**	**74,282**	**75,413**	**75,985**
Movement in CFR	**32,368**	**(238)**	**(8,668)**	**1,131**	**573**

Movement in CFR represented by					
Net financing need for the year (above)	34,274*	2,454	(6,120)	3,249	2,769
Less MRP/VRP and other financing movements	(1,906)	2,692	2,548	2,118	2,196
Movement in CFR	**32,368**	**(238)**	**(8,668)**	**1,133**	**573**

*The large increase in HRA financing requirement related to the HRA Self Financing payment.

2.3 Minimum Revenue Provision (MRP) Policy Statement

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

Government regulations 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:

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

This provides for reducing any associated borrowing need over the asset's life.

Whilst there is no requirement on the HRA to make a minimum revenue provision, with the move to self financing equal annual instalments of principal are being made in respect of the 30 year loan taken out at the end 2012/13. There is, however, a requirement for a charge for depreciation to be made, although there are transitional arrangements in place until CIPFA determine the most appropriate accounting treatment to be applied under self financing. At present depreciation is based on the value of the relevant asset components charged over the asset lives.

2.4 Core Funds and Expected Investment Balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or 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	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Fund balances / reserves	21,359	27,004	27,310	28,112	29,017
Capital receipts	210	0	0	0	0
Provisions	1,534	1,534	1,534	1,534	1,534
Other	200	100	0	0	0
Total core funds	**23,303**	**28,638**	**28,844**	**29,646**	**30,551**
Internal Investments*	6,188	7,129	(263)	2,067	3,791
Expected investments	**17,115**	**21,509**	**29,107**	**27,579**	**26,760**

*Internal investments relate to the difference between the CFR and the debt position as stated in section 3.1.

2.5 Affordability Prudential Indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances.

2.6 Ratio of Financing Costs to Net Revenue Stream

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

	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
General Fund	17.8%	14.7%	14.2%	12.3%	12.2%
HRA	6.7%	24.2%	23.2%	22.3%	21.7%
Overall Total	**13.7%**	**18.5%**	**17.9%**	**16.4%**	**16.1%**

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

2.7 Incremental Impact of Capital Investment Decisions on Council Tax

This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in the budget report compared to the Council's existing approved commitments and current plans.

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

	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Council tax - band D	**£2.28**	**-£4.20**	**£1.03**	**£3.13**	**£5.98**
Percentage Change	**1.19%**	**-2.18%**	**0.53%**	**1.56%**	**2.93%**

The large impact on band D council tax is due to a delayed capital receipt, relating to the sale of land in south Lancaster. This receipt is expected to be received during 2013/14.

Illustrative impact of an additional £1M borrowing is shown below.

	5 Years	10 Years	25 Years
Increase in Council Tax	**£4.78**	**£2.53**	**£1.33**
Percentage Change	**2.49%**	**1.31%**	**0.95%**

3 Borrowing

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 capital expenditure plans and related service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current Portfolio Position

The Council's treasury portfolio position at 31 March 2012 and forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£'000	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
External Debt					
Debt at 1 April	70,872	70,109	69,068	68,027	66,985
Other long-term liabilities (OLTL)	6,128	5,712	5,477	5,319	5,209
Total external debt at 31 March	**77,000**	**75,821**	**74,545**	**73,346**	**72,195**
The Capital Financing Requirement	**83,188**	**82,950**	**74,282**	**75,413**	**75,985**
Under / (over) borrowing	**6,188**	**7,129**	**(263)**	**2,067**	**3,791**

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2013/14 and the following two financial years. The over borrowing shown in 2013/14 reflects the application of the receipt from the sale of land at South Lancaster to reduce the underlying need to borrow, thereby reducing the CFR in that year. Thereafter, there is some flexibility for limited borrowing for future years.

The Head of Resources 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.

3.2 **Treasury Indicators: Limits to Borrowing Activity**

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

Operational boundary £m	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Debt	77	78	71	71
Other long term liabilities	5	5	5	5
Total	**82**	**83**	**76**	**76**

The authorised limit for external debt. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited. It reflects the level of external debt that, whilst not desired, could be afforded in the short term but may be unsustainable in the longer term. It is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

Authorised limit £m	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Debt	94	93	87	87
Other long term liabilities	6	6	6	6
Total	**100**	**99**	**93**	**93**

HRA Limit on Indebtedness £m	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Debt	**60**	**60**	**60**	**60**

3.3 **Prospects 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. The following table and commentary gives the Sector central view.

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

The economic recovery in the UK since 2008 has been the worst and slowest recovery in recent history, although the economy returned to positive growth in the third quarter of 2012. Growth prospects are weak and consumer spending, the usual driving force of recovery, is likely to remain under pressure due to consumers focusing on repayment of personal debt, inflation eroding disposable income, and general malaise about the economy and employment fears.

The primary drivers of the UK economy are likely to remain external. 40% of UK exports go to the Eurozone so the difficulties in this area are likely to continue to hinder UK growth. The US, the main world economy, faces similar debt problems to the UK, but urgently needs to resolve the fiscal cliff now that the the Presidential elections are out of the way. The resulting US fiscal tightening and continuing Eurozone problems will depress UK growth and it is likely to see the UK deficit reduction plans slip.

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

- The Eurozone sovereign debt difficulties provide a clear indication of high counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods.
- Investment returns are likely to remain relatively low during 2013/14 and beyond.
- Borrowing interest rates continue to be attractive and may remain relatively low for some time. The timing of any borrowing will need to be monitored carefully.
- There will remain a cost of carry – any borrowing undertaken that results in an increase in investments will incur a revenue loss between borrowing costs and investment returns.

3.4 Borrowing strategy

The continued uncertainty over future interest rates increases the risks associated with treasury activity. As a result there is no strong argument for a significant relaxation of the Council's treasury strategy.

The Head of Resources, 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 term.

Borrowing will only be taken on once a liability has been established although the timing of the borrowing may precede the point at which the liability actually falls due for payment. This would only be done to secure a preferential position for the Council, for example to benefit from lower interest rates.

With the likelihood of rates increasing, any debt restructuring is likely to focus on switching from longer term fixed rates to cheaper shorter term debt, although the Head of Resources and treasury consultants will monitor prevailing rates for any opportunities during the year. The benefit of this will be balanced against the risks attached to the more frequent refinancing that would be required.

The option of postponing borrowing and running down investment balances will be considered primarliry. This would have the added benefit of further reducing counterparty risk and also could support the revenue situation with the cost of loans currently far outweighing the return on investments.

4 Investment Strategy

4.1 Investment Strategy 2012/13 to 2014/15

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.

The types of investment allowable are categorised as either Specified and Non Specified investments. Details of these are set out in ***Annex B(1)***.

The current investment climate has an over-riding risk consideration, that of counterparty security risk. The Head of Resources 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.

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 Code.

Credit rating information is supplied by the Council's treasury consultants (Sector) on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria will 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 ***Annex B(2).***

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:

- are UK banks; or
- 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 3):

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

ii. Long Term: A/A2/A

iii. Individual Viability / Financial Strength: bb+/C (Fitch / Moody's only)

iv. Support: 3 (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 if they meet the ratings in Banks 1 above. Investment limits will be subject to the short and long term rating limits in the table at 4.2 below.

Banks 3 – 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).

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 (eg Natwest and RBS count as a single counterparty);
- Sector's limits will be monitored.

The Code and Investment Guidance 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, equity price, and media coverage) will be reviewed prior to investments being placed.

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.

4.2 Counterparty Criteria and Investment Limits

	Minimum across all three ratings			**Money Limit[8]**	**Time Limiit[9]**
	Fitch	**Moody's**	**Standard & Poors**		
Upper Limit[1]	**F1+/AA-**	**P-1/AA3**	**A-1+/AA-**	**£6M**	**Instant access only**
				£3M	**100 days**
Middle Limit[2]	**F1/A**	**P-1/A2**	**A-1/A**	**£3M**	**Instant access only**
Other Institutions[3]	**N/A**	**N/A**	**N/A**	**£6M**	**1 Year**
Lancashire County[4]	**N/A**	**N/A**	**N/A**	**£12M**	**1 Year**
Money Market Funds[5]	**AAA**	**AAA**	**AAA**	**£6M**	**Instant Access Only**
DMADF deposit[6]	**N/A**	**N/A**	**N/A**	**No limit**	**1 Year**
Sovereign rating to apply to all non UK counterparties[7]	**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), and non-specified investments (including part-nationalised banks).

4: This recognises the special status of Lancashire County Council as the City Council's upper tier authority.

5: Sterling, constant net asset value funds only.

6: The DMADF facility is direct with the UK government; it is extremely low risk.

7: UK counterparties are defined as those listed under UK banks or building societies in the Sector counterparty listing.

8: Money limits apply to principal invested and do not include accrued interest.

9: Time Limits start on the trade date for the investment.

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, 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 the above table.

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

There is some operational difficulty arising from the legacy of the banking crisis; although there is some value returning to longer term investment, credit risk remains within the market. Whilst some selective options do provide additional yield, uncertainty over counterparty creditworthiness indicates that shorter dated investments still provide better security. However, in line with limits in the previous table, fixed term investing is judged to be acceptable for certain institutions or where certain credit rating limits are met.

Council is asked to approve the base criteria above, although the Head of Resources may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval.

4.3 **Risk Benchmarking**

A further development in terms of managing risk is the use of benchmarks. Yield benchmarks are currently widely used to assess investment performance but there is little comparative data available to Members to assess where this strategy sits in comparison to other authorities in terms of the types of counterparty used and the lengths of deposit.

At present, the criteria set down 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 2012/13 strategy in being low risk through, for example, restricting the amount and length of deposit in any one counterparty as well as requiring high liquidity on most large deposits. The use of information from other authorities might allow the officers to refine the investment strategy once it is clearer how other local districts are performing and the investment parameters they are using. Officers will work towards obtaining comparative information from other Districts over the course of 2013/14 with a view to presenting this information to Members in due course.

4.4 **Treasury Management Indicators and Limits on Activity**

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 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.

Treasury Management Indicators

£m	2013/14		2014/15		2015/16	
Interest rate exposures (TM 1 & TM 2)						
	Upper		**Upper**		**Upper**	
Limits on fixed interest rates based on net debt	100%		100%		100%	
Limits on variable interest rates based on net debt	30%		30%		30%	
Maturity structure of fixed interest rate borrowing (TM3)						
	Lower	**Upper**	**Lower**	**Upper**	**Lower**	**Upper**
Under 12 months	0%	50%	0%	50%	0%	50%
12 months to 2 years	0%	50%	0%	50%	0%	50%
2 years to 5 years	0%	50%	0%	50%	0%	50%
5 years to 10 years	0%	50%	0%	50%	0%	50%
10 years to 15 years	0%	100%	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 (not including new HRA debt)						
Under 12 months	*0%*					
12 months to 2 years	*0%*					
2 years to 5 years	*0%*					
5 years to 10 years	*0%*					
10 years to 15 years	*0%*					
15 years to 25 years	*0%*					
25 years to 50 years	*100%*					
Maximum principal sums invested > 364 days (TM 4)						
Principal sums invested, in 2013/14 for periods of greater than 364 days, to mature after the end of each financial year	£0M		£0M		£0M	

4.5 **Treasury Management Advisers**

The Council currently uses Sector 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.

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

Annex A

Treasury Management Glossary of Terms

- **Annuity** – method of repaying a loan where the payment amount remains uniform throughout the life of the loan, therefore the split varies such that the proportion of the payment relating to the principal increases as the amount of interest decreases.

- **CIPFA** – the Chartered Institute of Public Finance and Accountancy, is the professional body for accountants working in Local Government and other public sector organisations, also the standard setting organisation for Local Government Finance.

- **Call account** – instant access deposit account.

- **Counterparty** – an institution (e.g. a bank) with whom a borrowing or investment transaction is made.

- **Credit Rating** – is an opinion on the credit-worthiness of an institution, based on judgements about the future status of that institution. It is based on any information available regarding the institution: published results, Shareholders' reports, reports from trading partners, and also an analysis of the environment in which the institution operates (e.g. its home economy, and its market sector). The main rating agencies are Fitch, Standard and Poor's, and Moody's. They analyse credit worthiness under four headings:

  - **Short Term Rating** – the perceived ability of the organisation to meet its obligations in the short term, this will be based on measures of liquidity.

  - **Long Term Rating** – the ability of the organisation to repay its debts in the long term, based on opinions regarding future stability, e.g. its exposure to 'risky' markets.

  - **Individual/Financial Strength Rating** – a measure of an institution's soundness on a stand-alone basis based on its structure, past performance and credit profile.

  - **Legal Support Rating** – a view of the likelihood, in the case of a financial institution failing, that its obligations would be met, in whole or part, by its shareholders, central bank, or national government.

  The rating agencies constantly monitor information received regarding financial institutions, and will amend the credit ratings assigned as necessary.

- **DMADF and the DMO –** The DMADF is the 'Debt Management Account Deposit Facility'; this is highly secure fixed term deposit account with the Debt Management Office (DMO), part of Her Majesty's Treasury.

- **EIP –** Equal Instalments of Principal, a type of loan where each payment includes an equal amount in respect of loan principal, therefore the interest due with each payment reduces as the principal is eroded, and so the total amount reduces with each instalment.

- **Gilts** – the name given to bonds issued by the UK Government. Gilts are issued bearing interest at a specified rate, however they are then traded on the markets like

shares and their value rises or falls accordingly. The Yield on a gilt is the interest paid divided by the Market Value of that gilt.
Eg. a 30 year gilt is issued in 1994 at £1, bearing interest of 8%. In 1999 the market value of the gilt is £1.45. The yield on that gilt is calculated as 8%/1.45 = 5.5%.
See also PWLB.

- **LIBID** – The London Inter-Bank Bid Rate, the rate which banks would have to bid to borrow funds from other banks for a given period. The official rate is published by the Bank of England at 11am each day based on trades up to that time.

- **LIBOR** – The London Inter-Bank Offer Rate, the rate at which banks with surplus funds are offering to lend them to other banks, again published at 11am each day.

- **Liquidity** – Relates to the amount of readily available or short term investment money which can be used for either day to day or unforeseen expenses. For example Call Accounts allow instant daily access to invested funds.

- **Maturity** – Type of loan where only payments of interest are made during the life of the loan, with the total amount of principal falling due at the end of the loan period.

- **Money Market Fund (MMF)** – Type of investment where the Council purchases a share of a cash fund that makes short term deposits with a broad range of high quality counterparties. These are highly regulated in terms of average length of deposit and counterparty quality, to ensure AAA rated status.

- **Policy and Strategy Documents** – documents required by the CIPFA Code of Practice on Treasury Management in Local Authorities. These set out the framework for treasury management operations during the year.

- **Public Works Loans Board (PWLB)** – a central government agency providing long and short term loans to Local Authorities. Rates are set daily at a margin over the Gilt yield (see Gilts above). Loans may be taken at fixed or variable rates and as Annuity, Maturity, or EIP loans (see separate definitions) over periods of up to fifty years. Financing is also available from the money markets, however because of its nature the PWLB is generally able to offer better terms.

- **Sector** – Sector are the City Council's Treasury Management advisors. They provide advice on borrowing strategy, investment strategy, and vetting of investment counterparties, in addition to ad hoc guidance throughout the year.

- **Yield** – see Gilts

Members may also wish to make reference to *The Councillor's Guide to Local Government Finance.*

Annex B (1)

Definitions of Specified and Non Specified Investments

See the detailed Investment Strategy 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.

(v) A body with high credit quality (such as a bank or building society).

For category (iv) this covers a money market fund AAA 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. Non specified investments not explicitly referred to below are excluded.

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 table in 4.2
(ii)	Lloyds Bank and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised.	Included as per table in 4.2
(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 table in 4.2

Annex B(2)

Background Information on Credit Ratings

Credit ratings are an important 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

2012/13 Treasury Management Progress Report to 31 December 2012

Report of Head of Resources

Introduction

It is a requirement of the CIPFA Code of Practice on Treasury Management that regular monitoring reports are presented to Members on treasury activities. These reports will normally be presented soon after the end of June, September, December and March as part of the Council's performance management framework.

Council approved the Treasury Strategy including the Investment Strategy for 2012/13 at its meeting on 29 February 2012. This report outlines activities undertaken in pursuance of those strategies during the financial year up to the end of Quarter 3.

Treasury management is a technical area. To assist with the understanding of this report, a glossary of terms commonly used in Treasury Management is attached at **Appendix C - Annex A**. In addition, the Councillor's Guide to Local Government Finance also has a section on treasury and cash management and this is available through the Member Information section on the Intranet.

Summary

- Payments have been made by KSF and Landsbanki, leaving outstanding amounts due of £154K and £583K respectively.

- On other treasury matters, since the HRA self financing transaction at the end of 2011/12 there have been no changes to the debt portfolio. No temporary borrowing was required during the quarter and no new long term debt has been taken on.

- There have been no material breaches of any prudential indicators or counterparty limits in the quarter and no other major risks have been identified.

Economic update (provided by Sector)

The Eurozone debt crisis has continued to cast a pall over the world economy and has depressed growth in most countries. This has impacted the UK economy which is unlikely to grow significantly in 2012 and is creating a major headwind for recovery in 2013. Quarter 2 of 2012 was the third quarter of contraction in the economy; this recession is the worst and slowest recovery of any of the five recessions since 1930. A return to growth at 1% in quarter 3 in unlikely to prove anything more than a washing out of the dip in the previous quarter before a return to weak, or even negative, growth in quarter 4.

Given the weak outlook for economic growth, Sector sees the prospects for any changes in Bank Rate before 2015 as very limited. There is potential for the start of Bank Rate increases to be even further delayed if growth disappoints.

Economic growth has basically flat lined since the election of 2010 and, worryingly, the economic forecasts for 2012 and beyond were revised substantially lower in the

Bank of England Inflation quarterly report for August 2012 and were then further lowered in the November Report. Quantitative Easing (QE) was increased again by £50bn in July 2012 to a total of £375bn. Many forecasters are expecting the MPC to vote for a further round of QE to stimulate economic activity regardless of any near-term optimism. The announcement in November 2012 that £35bn will be transferred from the Bank of England's Asset Purchase Facility to the Treasury (representing coupon payments to the Bank by the Treasury on gilts held by the Bank) is also effectively a further addition of QE.

	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%
5yr PWLB rate	1.50%	1.50%	1.60%	1.60%	1.70%	1.70%	1.80%	2.00%	2.20%
10yr PWLB rate	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	3.00%	3.20%
25yr PWLB rate	3.80%	3.80%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.30%
50yr PWLB rate	4.00%	4.00%	4.00%	4.00%	4.10%	4.10%	4.20%	4.30%	4.50%

Economic forecasting remains difficult with so many external influences weighing on the UK. Key areas of uncertainty include:

- The impact of the Eurozone crisis on financial markets and the banking sector.
- The impact of the UK Government's austerity plan on confidence and growth.
- Monetary policy action failing to stimulate growth in western economies.
- The potential for weak growth or recession in the UK's main trading partners - the EU and US.
- The potential for political issues to have an adverse impact e.g. trade disputes or political upheaval in the Middle East.

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. The interest rate forecast in this report represents a balance of downside and upside risks. The downside risks have already been commented on. However, there are upside risks as follows to PWLB rates and gilt yields, and especially to longer term rates and yields as the effects of Quantitative Easing reverse and the UK status as a relative safe haven declines as other economies improve.

Icelandic Investments Update

As reported in the year end report for 2011/12 there have been material repayments made against the Council's Icelandic deposits from all three banks. During quarter 1 2012/13 repayments were received from KSF (10%) and Landsbanki (12%). In quarter 3 further payments from Landsbanki (5.8%) and KSF (3%) were received. The current position is summarised below:

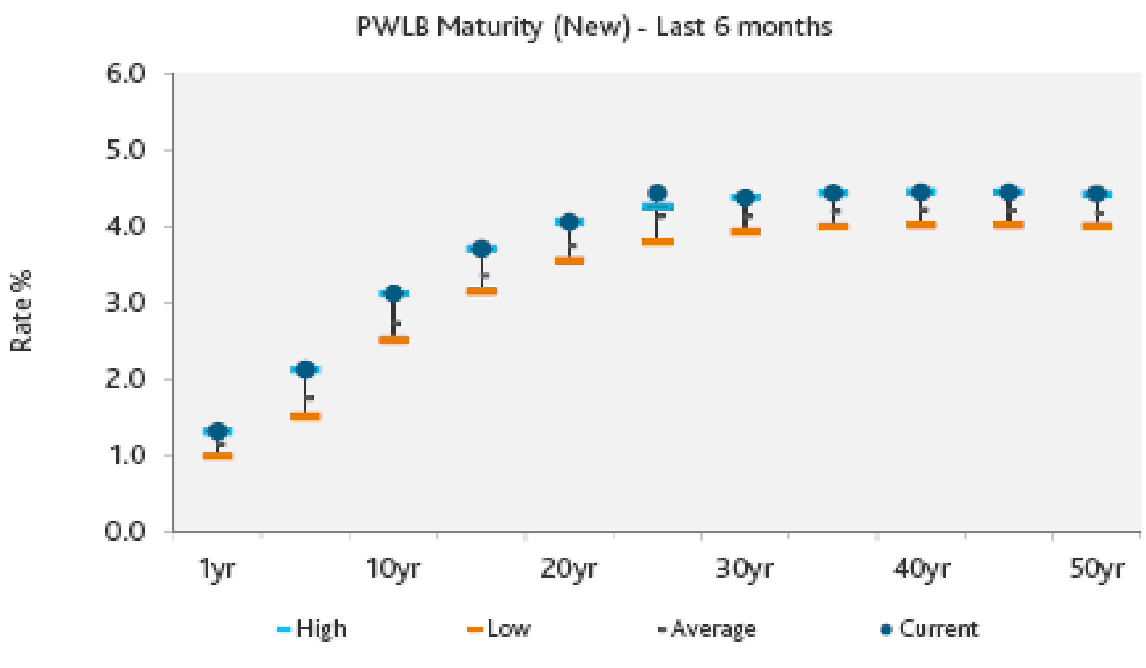
	KSF £000	Glitnir £000	Landsbanki £000	Total £000
Deposit	**2,000**	**3,000**	**1,000**	**6,000**
Claim	**2,048**	**3,173**	**1,121**	**6,342**
Payments received	**1,556**	**2,508**	**529**	**4,593**
Amounts held in ISK*		**571**	**8**	**579**
Total anticipated recovery (%)	**83.50%**	**100%**	**100%**	
Further payments due (%)	**7.50%**	**0%**	**52%**	
Further payments due (£000)	**154**	**0**	**583**	**737**
Total anticipated receipts	**1,710**	**3,079**	**1,119**	**5,908**

*These are earning interest but are also subject to currency fluctuations, these sums will be repatriated once Icelandic currency controls allow.

The total repayment in cash terms is now expected to be £5.9M meaning that the majority of the £6M principal invested will be returned.

Current Borrowing Rates.

There are few changes in relation to the cost of new debt. The graph below shows that the pattern seen since January 2009 has persisted, with a marked spread between short term and long term borrowing. Further, rates remain at their depressed levels even compared to the range seen over the last 6 months.



Extract from Sector weekly debt monitor 7/1/2013

However, as the Council is not currently looking to borrow, there is little immediate impact of these low rates. The main issue going forward could be that the margin between the Council's current loans and the threshold for avoiding penalties for early repayment will also increase but there are currently no plans to make early repayments and it will not be clear whether this is an attractive strategy until the cash demands linked to Lancaster Indoor Market are clarified, hopefully during quarters 3 and 4.

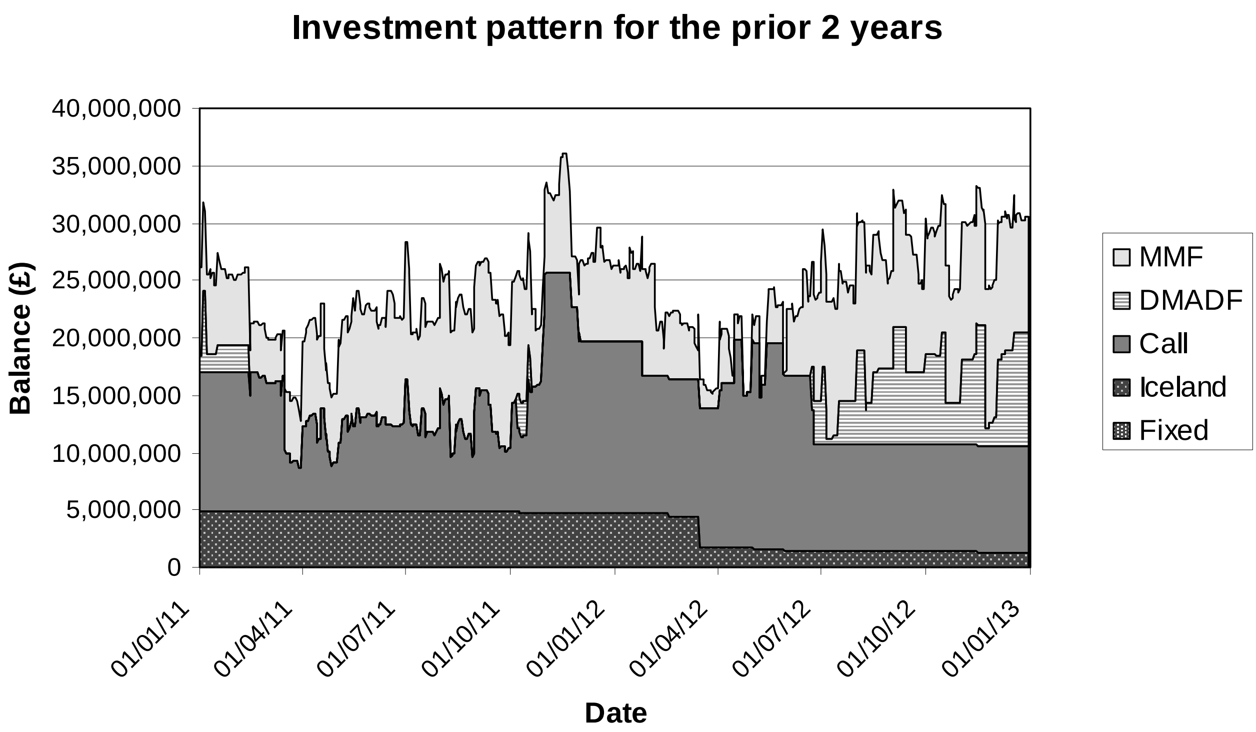
The £31M loan taken out at the end of March in respect of ending the HRA subsidy system was drawn down as an Equal Instalment of Principal (EIP) loan at 3.03% compared to the estimated 3.5%. This has resulted in annual saving of approximately £432K in interest which is split between the General Fund (£364K) and the HRA (£68K).

Investing Activities

As laid down in the approved Investment Strategy, the aim is to prioritise security and liquidity of the Council's investments. This is to ensure that the Council has sufficient cash to support its business, but also to minimise any further chance of a counterparty failing and the Council not being able to remove its deposits, as happened with the Icelandic banks.

All investment activity has been in line with the approved Treasury Strategy for 2012/13. No fixed term investments have been placed; surplus cash has been managed on a day to day basis using the call accounts and Money Market Funds (MMF). A full list of the investments at the end of Quarter 3 is shown below.

Other Investments	Opening	Min	Max	Closing	Indicative rate	Cumulative Interest £
Call: RBS	£ 3,000,000	£ 3,000,000	£ 3,000,000	£ -	0.80%	£ 5,589
Call: Barclays	£ 3,000,000	£ -	£ 3,000,000	£ -	0.55%	£ 3,707
Call: Lancashire County Council	£ 6,000,000	£ 6,000,000	£ 12,000,000	£ 9,300,000	0.70%	£ 49,750
DMADF	£ -	£ -	£ 10,530,000	£ 9,810,000	0.25%	£ 8,335
Government Liquidity MMF	£ -	£ -	£ 6,000,000	£ 3,840,000	0.32%	£ 8,223
Liquidity First MMF.	£ 1,850,000	£ -	£ 6,000,000	£ 6,000,000	0.64%	£ 23,204
Sub-total	£ 13,850,000			£ 28,950,000		£ 98,807
					Budgeted income	£ 121,829



In the last quarter the Council has tried to make full use of the capacity with the County Council, once current cash demands become clear it may be that fixed term deposits are placed with County although they are at present fully borrowed and not taking on further deposits. Towards the end of the first quarter, credit rating changes to RBS and Barclays meant that these counterparties fell off the investment list. This is being addressed in developing next year's strategy.

Given this and the reduced ability to place deposits with County, lower yielding accounts have been used such as the DMADF and governmental MMF accounts with a resultant loss of investment income. In addition, cash balances are lower than anticipated in the budget, the main reason being the ongoing delays with realising material capital receipts.

Summary of Budget Position and Performance

In terms of performance against external benchmarks, the return on investments compared to the 7 day LIBID and bank rates over the year to date is as follows:

Base Rate	0.50%
7 day LIBID	0.41%
Lancaster CC investments	0.54%

The return is just above base and is better than the 7 day LIBID benchmark which is positive given that the Council's investments are in the main on instant access. In absolute terms as the Council has focused on secure and highly liquid deposits the rate of return is very modest however, for the type of investment the Council is making, it is a reasonable rate.

In terms of performance against budget, the details are as follows:

	Annual Budget	**Profiled Budget**	**Actual to Date**	**Variance**
	£'000	£'000	£'000	£'000
Icelandic Credits	50	38	38	0
Cash Interest	164	123	99	24
Total	**214**	**161**	**137**	**24**

There is an £24K adverse variance which is jointly due to lower cash balances than anticipated, as noted in section 6, as well as reduced capacity on higher yielding accounts following limits placed by the County and credit rating reductions to Barclays and RBS.

The credits from Icelandic investments are accounting adjustments to the investments that still held with the Icelandic banks. These are real credits to the General Fund balance but are subject to adjustments depending on changes to the repayment profile of outstanding amounts. At present there is no reason to alter the assumptions made at budget time but this will be kept under review.

Risk management

There has been no material change in the policy or operation of the treasury function over the quarter, in recognition of the considerable uncertainty that exists within the economy and financial sector. The view is, therefore, that residual counterparty risk exposure for investment remains low.

There is financial risk attached to the longer term debt portfolio, associated with interest rate exposure but all of the debt is on fixed interest and there has been no change to this over the quarter. The low rates create a risk in terms of the ability to repay debt but the Council is not yet in position to be following such a strategy.

There have been very positive developments with the Icelandic banks over the last 3 quarters and the risk attached to uncertainty of the Council's creditor status has now been extinguished. There are still uncertainties over the timing and exact amounts of repayments, as well as how elements already repaid in ISK will be repatriated.

Further, there is an interest rate risk attached to the current investment strategy where the Council, as at December 2012, had only those nationalised or part nationalised high street banks it could deal with, on an instant access basis. The cost/benefit of the current strategy in being reviewed to ensure that the risk of foregone income is being actively monitored against a level of counterparty risk that is acceptable.