Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

English HRA local authorities
2013/14

This template was issued as at 3 December 2012

History of amendments to this template

31.10.12 first edition issued

1.11.12 appendix 5.1 amended to show the new PWLB certainty rates i.e. minus 20 bps on the standard rate. Also an amendment to pooled funds category in appendix 5.4 . Paragraph 3.3 amended.

20.11.12 Revised interest rate forecasts and extending forecasts from March 2015 to March 2016 added into template in paragraph 3.3 and appendix 5.1. Appendix 5.1 available separately as a file to download. Economic commentary updated in appendix 5.2.

3.12.12 CIPFA have issued an amendement to the Prudential Code 2011 to replace the net debt indicator with a gross debt indicator. CIPFA require this amendment to be implimented from 2013/14.
The Treasury Management Code Guidance Notes 2011 have also been amended to delete the treasury indicator for gross and net debt, rather than amend it.

- Paragraph 3.1 in this template has therefore been amended. There will be some situations where clients could find it difficult or impossible to comply with this new requirement beyond the short term e.g. MRP could reduce the CFR below gross debt when the only debt left would attract excessive premiums if it was prematurely repaid
- Some clients will also have a negative CFR and even if their debt is zero, technically they would not be able to comply with this PI

CIPFA guidance in the amendment is that the reasons for this situation should be clearly stated in the TMSS report.

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1 INTRODUCTION

1.1 Background

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

CIPFA defines treasury management as:

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

1.2 Reporting requirements

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of 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. *If applicable.* In addition, this Council will receive quarterly update reports.

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

Scrutiny
The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the XXXX Committee.

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;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

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

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsibe for scrutiny. The following training has been undertaken by members……… and further training will be arranged as required.
The training needs of treasury management officers are periodically reviewed.

1.5 Treasury management consultants

This is required by the 2011 Guidance Notes page 26/27.

The Council uses Sector as its external treasury management advisors.

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

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

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

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members overview and confirm capital expenditure plans.

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. Members are asked to approve the capital expenditure forecasts:

Capital expenditure £m	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Adult and children's services					
Highways etc.					
Leisure					
Non-HRA					
HRA					
Total					

Other long term liabilities. The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments. *Add in details of any new PFI scheme details if required to provide greater member information.*

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

Capital expenditure £m	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Non-HRA					
HRA					
Total					
Financed by:					
Capital receipts					
Capital grants					
Capital reserves					
Revenue					
Net financing need for the year					

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. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £XXm of such schemes within the CFR.

The Council is asked to approve the CFR projections below:

£m	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Capital Financing Requirement					
CFR – non housing					
CFR – housing					
Total CFR					
Movement in CFR					

Movement in CFR represented by					
Net financing need for the year (above)					
Less MRP/VRP and other financing movements					
Movement in CFR					

Note the MRP / VRP will include PFI / finance lease annual principal payments

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).

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

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

Either

- **Existing practice** - MRP will follow the existing practice outlined in former CLG regulations (option 1); *or*
- **Based on CFR** – MRP will be based on the CFR (option 2);

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

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

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3);
- **Depreciation method** – MRP will follow standard depreciation accounting procedures (option 4);

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

There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made (although there are transitional arrangements in place).

Insert also if the annuity method is being used.

Insert also if LAMS (Local Authority Mortgage Scheme) option being considered and this is a local preferred option

For authorities who participate in LAMS using the cash backed option, the mortgage lenders require a five year deposit from the local authority to match the five year life of the indemnity. The deposit placed with the mortgage lender provides an integral part of the mortgage lending, and is treated as capital expenditure and a loan to a third party. The Capital Financing Requirement (CFR) will increase by the amount of the total indemnity. The deposit is due to be returned in full at maturity, with interest paid either annually or on maturity. Once the deposit matures and funds are returned to the local authority, the returned funds are classed as a capital receipt, and the CFR will reduce accordingly. As this is a temporary (five years) arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application.

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

2.4 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources £m	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Fund balances / reserves					
Capital receipts					
Provisions					
Other					
Total core funds					
Working capital*					
Under/over borrowing**					
Expected investments					

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

***Details of planned over / under borrowing can be input if considered necessary.*

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. The Council is asked to approve the following indicators:

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
Non-HRA					
HRA					

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 this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

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

£	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Council tax - band D					

Some clients may wish to include separate committed and uncommitted spending impacts on the council tax, which could be used as a local indicator.

2.8 Estimates of the incremental impact of capital investment decisions on housing rent levels.

Similar to the council tax calculation, this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in this budget report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

Incremental impact of capital investment decisions on housing rent levels

£	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Weekly housing rent levels					

This indicator shows the revenue impact on any newly proposed changes, although any discrete impact will be constrained by rent controls. *A separate local indicator could be included to show the effect gross of subsidy.*

3 Borrowing

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

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

£m	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
External Debt					
Debt at 1 April					
Expected change in Debt					
Other long-term liabilities (OLTL)					
Expected change in OLTL					
Actual gross debt at 31 March					
The Capital Financing Requirement					
Under / (over) borrowing					

Sector note: There are some situations where authorities may not be able to comply with keeping their CFR below their gross debt beyond the short term. CIPFA guidance is that the reasons for this situation should be clearly stated in this TMSS report. Please add a suitable explanation if this situation applies.

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2013/14 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Director of Finance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.2 Treasury Indicators: limits to borrowing activity

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

Operational boundary £m	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Debt				
Other long term liabilities				
Total				

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

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

Authorised limit £m	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Debt				
Other long term liabilities				
Total				

Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently:

HRA Debt Limit £m	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Total				

- *Since the limit is based on gross borrowing, show gross maximum borrowing for the year.*
- *Clients may also want to consider showing figures net of transferred debt, or inclusive of off balance sheet PFI etc., as a separate local indicator.*
- *Ensure that the authorised limit also allows for any potential overdraft position as this will be counted against the overall borrowing, and provides headroom for rescheduling (i.e. borrowing in advance of repayment).*

3.3 Prospects for interest rates

A more detailed interest rate view and economic commentary is at appendices 5.1 and 5.2 if required

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

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

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

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

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

- 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

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

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

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates* (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast,* perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

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

- *Each council will now need to state its own particular preferences and strategy…..*

Treasury management limits on activity

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

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments *(Clients are advised to use £ principal or £ interest payment figures rather than % if you operate significant investments);*
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;

  Additional local indicators are also shown purely for either debt or investments

- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits. *Consider local indicator covering both fixed and variable debt.*

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

£m	2013/14	2014/15	2015/16
Interest rate exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt			
Limits on variable interest rates based on net debt			
Limits on fixed interest rates:			

• *Debt only* • *Investments only*			
Limits on variable interest rates • *Debt only* • *Investments only*			

Maturity structure of fixed interest rate borrowing 2013/14		
	Lower	**Upper**
Under 12 months	0%	
12 months to 2 years	0%	
2 years to 5 years	0%	
5 years to 10 years	0%	
10 years and above	0%	
Maturity structure of variable interest rate borrowing 2013/14		
	Lower	***Upper***
Under 12 months	*0%*	
12 months to 2 years	*0%*	
2 years to 5 years	*0%*	
5 years to 10 years	*0%*	
10 years and above	*0%*	

Indicators for debt only and investments only as well as fixed and variable debt maturity profile have been included as local indicators.

Please note that the maturity structure guidance changed in the 2011 guidance notes (page 15) for lobo loans, the maturity date is now deemed to be the next call date.

3.5 Policy on borrowing in advance of need

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

(If desired) Borrowing in advance will be made within the constraints that:

- It will be limited to no more than XX% of the expected increase in borrowing need (CFR) over the three year planning period; and
- Would not look to borrow more than XX months in advance of need.

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

3.6 Debt rescheduling

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;

- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to the *Cabinet / Council (delete as appropriate)*, at the earliest meeting following its action

4 ANNUAL INVESTMENT STRATEGY

Sector note: *Sector has provided two options for clients to use for their creditworthiness policy: -.*

- *Option 1 is based on clients using the colour coded Sector creditworthiness service.*
- *Option 2 is based on clients using credit ratings supplied by Sector to apply the lowest common denominator method of choosing creditworthy counterparties.*

If clients wish to deviate from these two options, you will need to use your own words to explain your policy (see also a suggested credit rating criteria matrix in paragraph 4.8 external cash fund managers).

Option 1.

4.1 Investment policy

The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second and then return.

In accordance with guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of what these reflect in the eyes of each agency. Using the Sector ratings service potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

Furthermore, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings. This is fully integrated into the credit methodology provided by the advisors, Sector in producing its colour codings which show the varying degrees of suggested creditworthiness.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

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

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

Investment instruments identified for use in the financial year are listed in appendix 5.3 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices – schedules.

4.2 Creditworthiness policy

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

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

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

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

** Sector note: this category is for AAA rated Government debt or its equivalent; please also see collateralised deposits added into appendix 5.3 as an investment instrument.*

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

Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of short term rating F1, long term rating A-, viability rating of A-, and a support rating of 1 There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored *<< state how frequently >>.* The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

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

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

(if used) **The Local Authority Mortgage Scheme (LAMS)** – The Council is currently particpating in the cash backed mortgage scheme which requires the Council to place a matching five year deposit to the life of the indemnity. This investment is an integral part of the policy initiative and is outside the criteria above.

4.3 Country limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of *XX (whichever other rating you have set)* from Fitch *(or equivalent)*. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 5.5. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

Sector notes

1.If clients use different criteria then this section should be altered and appendix 5.3 amended accordingly.2. Clients who use sector limits e.g. banks v. building societies, should include a paragraph explaining their limits. Sector's view is that all councils should avoid a concentration of investments in too few counterparties or countries but that a suitable spreading approach in itself is likely to be sufficient given the safeguards already built into its creditworthiness service. Clients may wish to consider a spreading requirement of no more than say 20% of an investment portfolio with one counterparty, country etc but investment portfolios vary considerably in size and any such policy needs to be workable.

3. While the UK currently has an AAA sovereign rating, it is possible that the UK could have this rating downgraded by one, or more, rating agencies. It is therefore suggested that clients consider NOT setting a minimum sovereign rating of AAA so as to ensure continuity of being able to invest in UK banks if such a downgrading were to occur.

Sector note: Option 2. *This section is based on clients using credit ratings supplied by the Sector creditworthiness service to apply the lowest common denominator approach.*

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.

In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of these reflect in the eyes of each agengy. Using the Sector ratings service potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

Further, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

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

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

Investment instruments identified for use in the financial year are listed in appendix 5.4 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices – schedules.

4.2 Creditworthiness policy

The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

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

Council's prudential indicators covering the maximum principal sums invested.

The Director of Finance 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. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria. Credit rating information is supplied by Sector, our treasury consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions. *(amend as necessary whether all negative watches result in removal, or only those at the minimum, or add your own criteria for such circumstances).*

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

- Banks 1 - good credit quality – the Council will only use banks which:
  i. are UK banks; and/or
  ii. are non-UK and domiciled in a country which has a minimum sovereign long term rating of XX

  and have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):
  i. Short term - *XXX*
  ii. Long term – *XXX*
  iii. Viability / financial strength – *XXX* (Fitch / Moody's only)
  iv. Support – *XXX* (Fitch only)
- Banks 2 – Part nationalised UK banks – Lloyds Banking Group and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
- Banks 3 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- Bank subsidiary and treasury operation -. The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above. (*This may be deleted if not required – note that a subsidiary without a guarantee or adequate ratings may not be considered suitable for inclusion).*

- Building societies *(delete as appropriate or if not required – bear in mind that these institutions have had their ratings reduced and there is little overt support for their inclusion).* The Council will *use* all societies which:
    i. meet the ratings for banks outlined above;
    ii. Have assets in excess of *XXX*;

    or meet both criteria.
- Money market funds – *XXX*
- UK Government (including gilts and the DMADF)
- Local authorities, parish councils etc
- Supranational institutions
- *(If applicable)* Local Authority Mortgage Scheme. Under this scheme the Council is required to place funds of £xx, with XXXXX for a period of X years. This is classified as being a service investment, rather than a treasury management investment, and is therefore outside of the specified / non specified categories.
- *Insert other as required. This may cover property funds, corporate bonds etc.*

A limit of XX% will be applied to the use of non-specified investments (*this will partially be driven by the long term investment limits*).

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

- no more than XX% will be placed with any non-UK country at any time;
- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

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

Time and monetary limits applying to investments. The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both specified and non-specified investments):

	Fitch Long term Rating (or equivalent)	Money Limit	Time Limit
Banks 1 higher quality	***XXX***	**£XXm**	**XXyrs**

Banks 1 medium quality	***XXX***	**£XXm**	**XXyrs**
Banks 1 lower quality	***XXX***	**£XXm**	**XXyrs**
Banks 2 – part nationalised	**N/A**	**£XXm**	**1yr**
Limit 3 category – Council's banker (not meeting Banks 1)	**XXX**	**£XXm**	**1 day**
Other institutions limit	**-**	**£XXm**	**XXyrs**
DMADF	**AAA**	**unlimited**	**6 months**
Local authorities	**N/A**	**£XXm**	**XXyrs**
Money market funds	**AAA**	**£XXm**	**liquid**

(These categories should begin with the higher quality institutions, embodying larger £ limits and longer time limits, with subsequent limits tapering down according to lower criteria. The Banks 1 category may be for greater than 1 year and will therefore include relatively high rated institutions {AA}. The other institutions limit category will normally be the minimum criteria and another limit may be included for unrated subsidiaries and building societies (if you choose to use these). This may therefore be deleted if the Council does not plan using these types of institution. The other institution limit will be for other local authorities, the DMADF, money market funds and gilt and supranational investments. These are all considered high quality names – although not always rated – and therefore will likely have the same limit as the upper category. Guaranteed institutions will need to be restricted to the terms of the guarantee.)

3. The proposed criteria for specified and non-specified investments are shown in Appendix 5.4 for approval.

4.3 Country limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of *XX (which ever other rating you have set)* from Fitch *(or equivalent)*. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

Sector notes

1.If clients use different criteria then this section should be altered and appendix 5.3 amended accordingly.

2. Clients who use sector limits e.g. banks v. building societies, should include a paragraph explaining their limits. Sector's view is that all councils should avoid a concentration of investments in too few counterparties or countries but that a suitable spreading approach in itself is likely to be sufficient given the safeguards already built into its creditworthiness service. Clients may wish to consider a spreading requirement of no more than say 20% of an investment portfolio with one counterparty, country etc but investment portfolios vary considerably in size and any such policy needs to be workable.

3. While the UK currently has an AAA sovereign rating, it is possible that the UK could have this rating downgraded by one, or more, rating agencies. It is therefore suggested that clients consider NOT setting a minimum sovereign rating of AAA so as to ensure continuity of being able to invest in UK banks if such a downgrading were to occur.

***Sector note:** The following paragraphs are applicable to both options 1 and 2.*

4.4 Investment strategy

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

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

- 2012/13 0.50%
- 2013/14 0.50%
- 2014/15 0.75%
- 2015/16 1.75%

There are downside risks to these forecasts (i.e. start of increases in Bank Rate is delayed even further) if economic growth remains weaker for longer than expected. However, should the pace of growth pick up more sharply than expected there could be upside risk, particularly if Bank of England inflation forecasts for two years ahead exceed the Bank of England's 2% target rate.

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

2012/13	0.50%
2013/14	0.50%
2014/15	0.60%
2015/16	1.50%

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

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

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

Sector notes

1. Councils which are able to place investments for an average period of three months may prefer to set a budget for investment earnings in line with the Sector three month LIBID forecasts shown in appendix 5.1.

2. Councils which place investments for longer periods than three months will need to adjust the average figures above as appropriate as will local authorities that use liquidity and other accounts arranged through Sector which offer higher rates than those available through brokers in the money markets..

(If the Authority's view differs from the above view, insert here)

Against this view the Treasury officers expect……..

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

4.5 Icelandic bank investments

(*if applicable*) – Update as necessary

4.6 Investment risk benchmarking

(if using the Sector SLY model).
These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report.
Security - The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

- **X.XX% historic risk of default when compared to the whole portfolio.**

Liquidity – in respect of this area the Council seeks to maintain:

- Bank overdraft - £XXXm
- Liquid short term deposits of at least £XXXm available with a week's notice.
- Weighted average life benchmark is expected to be XX.X years, with a maximum of XX.X years.

Yield - local measures of yield benchmarks are *(delete as necessary):*

- Investments – internal returns above the 7 day LIBID rate
- Investments – external fund managers - returns 110% above 7 day compounded LIBID.

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

	1 year	2 years	3 years	4 years	5 years
Maximum	**X.XX%**	**X.XX%**	**X.XX%**	**X.XX%**	**X.XX%**

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

4.7 End of year investment report

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

4.8 External fund managers *(if applicable)*

£__m of the Council's funds are externally managed on a discretionary basis by *<<name of manager(s)>>*

The Council's external fund manager(s) will comply with the Annual Investment Strategy. The agreement(s) between the Council and the fund manager(s) additionally stipulate guidelines and duration and other limits in order to contain and control risk.

The minimum credit criteria to be used by the cash fund manager(s) are as follows: -

	Fitch	Moodys	Standard and Poors
Long term			
Short term			
Viability / financial strength			N/A
Support		N/A	N/A

[Some clients may wish to just identify the fund manager contract which contains details of how investments can be made. By just using the above table, it will not give full details of what the manager(s) can do]

The fund manager's view on interest rates and opportunities for gilts / bonds is as follows:

5 Appendices

(These can be appended to the report or omitted as required)

1. Interest rate forecasts
2. Economic background
3. Treasury management practice 1 – credit and counterparty risk management (option 1)
4. Treasury management practice 1 – credit and counter[party risk management (option 2)
5. Approved countries for investments
6. Treasury management scheme of delegation
7. The treasury management role of the section 151 officer

5.1 APPENDIX: Interest Rate Forecasts 2013 - 2016 - this is now in a separate downloadable file

5.2 APPENDIX: Economic Background

The Global economy

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 @ 1% in quarter 3 in ulikely 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.

The **Eurozone sovereign debt crisis** has abated somewhat following the ECB's pledge to buy unlimited amounts of bonds of countries which ask for a bailout. The immediate target for this statement was Spain which continues to prevaricate on making such a request and so surrendering its national sovereignty to IMF supervision. However, the situation in Greece is heading towards a crunch point as the Eurozone imminently faces up to having to relax the time frame for Greece reducing its total debt level below 120% of GDP and providing yet more financial support to enable it to do that. Many commentators still view a Greek exit from the Euro as inevitable as total debt now looks likely to reach 190% of GDP i.e. unsustainably high. The question remains as to how much damage a Greek exit would do and whether contagion would spread to cause Portugal and Ireland to also leave the Euro, though the longer a Greek exit is delayed, the less are likely to be the repercussions beyond Greece on other countries and on EU banks.

Sentiment in financial markets has improved considerably since this ECB action and recent Eurozone renewed commitment to support Greece and to keep the Eurozone intact. However, the foundations to this "solution" to the Eurozone debt crisis are still weak and events could easily conspire to put this into reverse.

The US economy has only been able to manage weak growth in 2012 despite huge efforts by the Federal Reserve to stimulate the economy by liberal amounts of quantitative easing (QE) combined with a commitment to a continuation of ultra low interest rates into 2015. Unemployment levels have been slowly reducing but against a background of a fall in the numbers of those available for work. The fiscal cliff facing the President at the start of 2013 has been a major dampener discouraging business from spending on investment and increasing employment more significantly in case there is a sharp contraction in the economy in the pipeline. However, the housing market does look as if it has, at long last, reached the bottom and house prices are now on the up.

Hopes for a broad based recovery have, therefore, focused on the **emerging markets**. However, there are increasing concerns over flashing warning signs in various parts of the Chinese economy that indicate it may be heading for a hard landing rather than a gradual slow down.

The UK economy

The Government's austerity measures, aimed at getting the public sector deficit into order over the next four years, now look as if they will fail to achieve their objectives within the original planned timeframe. Achieving this target is dependent on the UK economy growing at a reasonable pace but recession in the Eurozone, our biggest trading partner, has depressed growth whilst tax receipts have not kept pace with additional welfare benefit payments. It will be important for the Government to retain investor confidence in UK gilts so there is little room for it to change course other than to move back the timeframe.

Currently, the UK is enjoying a major financial benefit from some of the lowest sovereign borrowing costs in the world as the UK is seen as a safe haven from Eurozone debt. There is, though, little evidence that consumer confidence levels are recovering nor that the manufacturing sector is picking up. On the positive side, growth in the services sector has rebounded in Q3 and banks have made huge progress since 2008 in shrinking their balance sheets to more manageable levels and also in reducing their dependency on wholesale funding. However, availability of credit remains tight in the economy and the Funding for Lending scheme, which started in August 2012, has not yet had the time to make a significant impact. Finally, the housing market remains tepid and the outlook is for house prices to be little changed for a prolonged period.

Economic Growth. 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.

Unemployment. The Government's austerity strategy has resulted in a substantial reduction in employment in the public sector. Despite this, total employment has increased to the highest level for four years as over one million jobs have been created in the private sector in the last two years.

Inflation and Bank Rate. Inflation has fallen sharply during 2012 from a peak of 5.2% in September 2011 to 2.2% in September 2012. However, inflation increased back to 2.7% in October though it is expected to fall back to reach the 2% target level within the two year horizon.

AAA rating. The UK continues to enjoy an AAA sovereign rating. However, the credit rating agencies will be carefully monitoring the rate of growth in the economy as a disappointing performance in that area could lead to a major derailment of the plans to contain the growth in the total amount of Government debt over the next few years. Moody's has stated that it will review the UK's Aaa rating at the start of 2013.

Sector's forward view

Economic forecasting remains difficult with so many external influences weighing on the UK. There does, however, appear to be consensus among analysts that the economy remains relatively fragile and whilst there is still a broad range of views as to potential performance, expectations have all been downgraded during 2012. Key areas of uncertainty include:

- the potential for the Eurozone to withdraw support for Greece at some point if the costs of such support escalate were to become prohibitive, so causing a worsening of the Eurozone debt crisis and heightened risk of the breakdown of the bloc or even of the currency itself;

- inter government agreement on how to deal with the overall Eurozone debt crisis could fragment; the impact of the Eurozone crisis on financial markets and the banking sector;

- the impact of the Government's austerity plan on confidence and growth and the need to rebalance the economy from services to manufactured goods;
- the under-performance of the UK economy which could undermine the Government's policies that have been based upon levels of growth that are unlikely to be achieved;
- the risk of the UK's main trading partners, in particular the EU and US, falling into recession ;
- stimulus packages failing to stimulate growth;
- elections due in Germany in 2013;
- potential for protectionism i.e. an escalation of the currency war / trade dispute between the US and China.
- the potential for action to curtail the Iranian nuclear programme
- the situation in Syria deteriorating and impacting other countries in the Middle East

The focus of so many consumers, corporates and banks on reducing their borrowings, rather than spending, will continue to act as a major headwind to a return to robust growth in western economies.

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

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 specific identifiable upside risks as follows to PWLB rates and gilt yields, and especially to longer term rates and yields: -

- UK inflation being significantly higher than in the wider EU and US causing an increase in the inflation premium in gilt yields
- Reversal of QE; this could initially be allowing gilts held by the Bank to mature without reinvesting in new purchases, followed later by outright sale of gilts currently held
- Reversal of Sterling's safe haven status on an improvement in financial stresses in the Eurozone
- Investors reverse de-risking by moving money from government bonds into shares in anticipation of a return to worldwide economic growth
- The possibility of a UK credit rating downgrade (Moody's has stated that it will review the UK's Aaa rating at the start of 2013).

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

Sector Note.This appendix should be used in conjunction with option 1 under section 4.1 – 4.3

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

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

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

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

Sector Notes.

- *It is suggested that clients using the Sector creditworthiness service should enter in the table below the appropriate lowest colour band.*
- *If not using our service based on colour bands, then please specify minimum credit ratings : -*
  short-term __, long-term __, viability / financial strength __, support __ (where applicable)

- *The criteria in this appendix are intended to be the operational criteria in normal times. At times of heightened volatility, risk and concern in financial markets, this strategy may be amended by temporary operational criteria further limiting investments to counterparties of a higher creditworthiness and / or restricted time limits*
- *Please divide the table below between specified and non specified as appropriate*

	*** Minimum credit criteria / colour band**	**** Max % of total investments/ £ limit per institution**	**Max. maturity period**
DMADF – UK Government	N/A	**100%**	**6 months**
UK Government gilts	UK sovereign rating		XX years
UK Government Treasury blls	UK sovereign rating		XX years
Bonds issued by multilateral development banks	UK sovereign rating		6 months
Money market funds	AAA	100%	Liquid

Local authorities	N/A	100%	Xx years
Term deposits with banks and building societies	Yellow Purple Blue Orange Red Green No Colour		Up to 5 years Up to 2 years Up to 1 year Up to 1 year Up to 6 Months Up to 3 months Not for use
CDs or corporate bonds with banks and building societies	Yellow Purple Blue Orange Red Green No Colour		Up to 5 years Up to 2 years Up to 1 year Up to 1 year Up to 6 Months Up to 3 months Not for use
Enhanced cash funds			
Corporate bond funds			
Gilt funds	UK sovereign rating		
Property funds			
(If applicable) **Local Authority Mortgage Scheme.** Under this scheme the Council is required to place funds of £xx, with XXXXX for a period of X years. This is classified as being a service investment, rather than a treasury management investment, and is therefore outside of the specified / non specified categories.			

Clients who use a greater range of investment instruments and / or cash fund managers, should consider using more detailed tables as below (please tailor these to your requirements).

ENGLISH LOCAL AUTHORITIES

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

	*** Minimum 'High' Credit Criteria**	**Use**
Debt Management Agency Deposit Facility	--	In-house
Term deposits – local authorities	--	In-house
Term deposits – banks and building societies **	See note 1	In-house
Term deposits – banks and building societies **	* Short-term __, Long-term __, Viability __, Support __	Fund Managers

Term deposits with nationalised banks and banks and building societies

	*** Minimum Credit Criteria**	**Use**	***** Max % of total investments**	**Max. maturity period**
UK part nationalised banks	See note 1	In-house		
UK part nationalised banks	UK sovereign rating or * Short-term __, Long-term __, Viability __, Support __Sovereign rating	Fund Managers		
Banks part nationalised by high credit rated (sovereign rating) countries – non UK	Sovereign rating or * Short-term __, Long-term __, Viability __, Support __Sovereign rating	In-house and Fund Managers		

Note 1. It is suggested that clients using the Sector creditworthiness service should enter here the lowest colour band. If not using our service then please use the previous approach: -
** short-term __, long-term __,viability/ financial strength __, support __*

** LA to specify*

Sector note: if clients wish to use a subsidiary of a parent bank and the subsidiary does not have a credit rating in its own right, then details of the guarantee from the parent should be added to this appendix. Sector suggests that clients should only rely on unconditional guarantees.

*** need to specify list of countries approved for investing with their banks*

Each authority to determine whether the categories of investments below fall into specified or non specified if these investments are for maturities under 1 year and have a high credit rating.

Collateralised deposit (see note 2)	UK sovereign rating or note 1	In-house and Fund Managers
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	UK sovereign rating or note 1	In-house
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	UK sovereign rating or * Short-term __, Long-term __, Viability __, Support __	Fund Managers
UK Government Gilts	UK sovereign rating	In-house buy and hold and Fund Managers
Bonds issued by multilateral development banks	AAA (or state your criteria if different)	In-house buy and hold and Fund Managers
Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government (refers solely to GEFCO - Guaranteed Export Finance Corporation)	UK sovereign rating	In-house buy and hold and Fund Managers
Sovereign bond issues (other than the UK govt)	AAA (or state your criteria if different)	In-house buy and hold and Fund Managers
Treasury Bills	UK sovereign rating	In house and Fund Managers

Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): -		
1. Government Liquidity Funds	* Long-term __ volatility rating	In-house and Fund Managers
2. Money Market Funds	* Long-term __ volatility rating	In-house and Fund Managers
3. Enhanced cash funds	* Long-term __ volatility rating	In-house and Fund Managers
4. Bond Funds (see note 3)	* Long-term __ volatility rating	In-house and Fund Managers
5. Gilt Funds	* Long-term __ volatility rating	In-house and Fund Managers

Note 1. It is suggested that clients using the Sector creditworthiness service should enter here the lowest colour band. If not using our service then please use the previous approach: -
** short-term __, long-term __, viability __, support __ (where applicable)*

** LA to specify*

If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate.
N.B. buy and hold may also include sale at a financial year end and repurchase the following day in order to accommodate the requirements of SORP.

Note 2. as collateralised deposits are backed by collateral of AAA rated local authority LOBOs, this investment instrument is regarded as being a AAA rated investment as it is equivalent to lending to a local authority.

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

NON-SPECIFIED INVESTMENTS: *(please select from table below)* A maximum of ___% ** will be held in aggregate in non-specified investment

1. Maturities of ANY period

	* Minimum Credit Criteria	Use	** Max % of total investments	Max. maturity period
Fixed term deposits with variable rate and variable maturities: -Structured deposits	See note 1	In-house		
(if using) Term deposits with unrated counterparties : any maturity	* *state alternative to credit criteria*	In-house		
Commercial paper issuance covered by a specific UK Government (explicit) guarantee	UK sovereign rating or note 1	In-house		
Commercial paper issuance covered by a specific UK Government (explicit) guarantee	UK sovereign rating or * Short-term __, Long-term __, Viability __, Support __	Fund Managers		
Commercial paper other	* Short-term __, Long-term __, Viability __, Support __	In-house		
Corporate bonds	* Short-term __, Long-term __, Viability __, Support __	In-house and Fund Managers		
Other debt issuance by UK banks covered by UK Government (explicit) guarantee	UK sovereign rating or * Short-term __, Long-term __, Viability __, Support __	In-house and Fund Managers		
Floating rate notes	* Long-term __,	Fund Managers		
Property fund: ***the use of these investments would constitute capital expenditure***	--	In house and Fund Managers		

Note 1. It is suggested that clients using the Sector creditworthiness service should enter here the lowest colour band. If not using our service then please use the previous approach: -
** short-term __, long-term __,viability / financial strength __, support __*

** LA to specify*

*** when setting this limit include both in-house and externally managed funds.*

2. Maturities in excess of 1 year

	*** Minimum Credit Criteria**	**Use**	**** Max % of total investments**	**Max. maturity period**
Term deposits – local authorities	--	In-house		
Term deposits – banks and building societies	See note 1	In-house		
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	UK sovereign rating or note 1	In-house		
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	UK sovereign rating or * Short-term __, Long-term __, Viability __, Support __	Fund Managers		
Certificates of deposit issued by banks and building societies	See note 1	In-house		
Certificates of deposit issued by banks and building societies e	*Short-term __, Long-term __, Viability __, Support __	Fund Managers		
UK Government Gilts	UK sovereign rating	In-house and Fund Managers		
Bonds issued by multilateral development banks	AAA (or state your criteria if different)	In-house and Fund Managers		
Sovereign bond issues (other than the UK govt)	AAA (or state your criteria if different)	In-house and Fund Managers		
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)				
1. Bond funds	* Long-term __ volatility rating	In-house and Fund Managers		
2. Gilt funds	* Long-term __ volatility rating	In-house and Fund Managers		

** LA to specify*

*** when setting this limit include both in-house and externally managed funds.*

Note 1. It is suggested that clients using the Sector creditworthiness service should enter here the lowest colour band. If not using our service then please use the previous approach: -
** short-term __, long-term __, viability/ financial strength __, support __(where applicable)*

Sector note: if clients wish to use a subsidiary of a parent bank and the subsidiary does not have a credit rating in its own right, then details of the guarantee from the parent should be added to this appendix. Sector suggests that clients should only rely on unconditional guarantees.

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

Sector Note.This appendix should be used in conjunction with option 2 under section 4.1 – 4.3

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

The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the Code on XX/XX/XXXX and will apply its principles to all investment activity. In accordance with the Code, the Director of Finance has produced its treasury management practices (TMPs). This part, TMP 1(5), covering investment counterparty policy requires approval each year.

Annual investment strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Council is:

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

Specified investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

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

investment vehicles, such as money market funds, rated *XXX* by Standard and Poor's, Moody's or Fitch rating agencies.

5. A body that is considered of a high credit quality (such as a bank or building society *{although non-rated subsidiaries and low or non-rated building societies will need to be non-specified investments. Check if you are investing in those institutions directly and not through a specific subsidiary.}*). For category 5 this covers bodies with a minimum short term rating of XXX (or the equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies.

Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies. This criteria is…… (*insert and include monetary limits from body of main report. As the main criteria covers short, long, viability and support ratings, applying only short term ratings will bring in Eligible Institutions etc.).*

Non-specified investments –are any other type of investment (i.e. not defined as specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investments would include any sterling investments *(the guidance does not specify sterling so its inclusion is optional for English authorities)* with:

	Non Specified Investment Category	**Limit (£ or %)**
a.	**Supranational bonds greater than 1 year to maturity** **(a) Multilateral development bank bonds** - These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Investment Bank etc.). **(b) A financial institution that is guaranteed by the United Kingdom Government** (e.g. The Guaranteed Export Finance Company {GEFCO}) The security of interest and principal on maturity is on a par with the Government and so very secure. These bonds usually provide returns above equivalent gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	AAA long term ratings (or other of your choice)
b.	**Gilt edged securities** with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	
c.	***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.***	
d.	**Building societies not meeting the basic security requirements under the specified investments**. The operation of some building societies does not require a credit rating, although in every other respect	

	the security of the society would match similarly sized societies with ratings. The Council may use such building societies which have a minimum asset size of £*XX*m, but will restrict these type of investments to *XXX (insert local criteria from body of main report*)	
e.	Any **bank or building society** that has a minimum long term credit rating of XXX, for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	*[The percentage limit links to the PI on investments over 1yr]*
f.	Any **non rated subsidiary** of a credit rated institution included in the specified investment category. These institutions will be included as an investment category subject to…. (*insert criteria such as a guarantee from the parent company, and the maximum period of investment – as per body of main report).*	
g.	**Share capital** * in a body corporate – The use of these instruments will be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. Revenue resources will not be invested in corporate bodies. There is a higher risk of loss with these types of instruments.	
h.	**Loan capital** in a body corporate –There is a higher risk of loss with this type of instrument. *Please put criteria in if being considered*	
i.	**Bond funds** – There is a higher risk of loss with this type of instrument. *Please put criteria in if being considered*	
j.	**Pooled property funds** – The use of these instruments will normally be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. The key exception to this is an investment in the CCLA Local Authorities Property Fund.	

Within categories c and d, and in accordance with the Code, the Council has developed additional criteria to set the overall amount of monies which will be invested in these bodies. This criteria is…… (*Insert the local criteria and include the procedures for determining the maximum periods for investments. Again include the effect of multilateral development banks and fund managers*).

In respect of category g, these will only be considered after obtaining external advice and subsequent member approval.

(If applicable) Local Authority Mortgage Scheme. Under this scheme the Council is required to place funds of £xx, with XXXXX for a period of X years. This is classified as being a service investment, rather than a treasury management investment, and is therefore outside of the specified / non specified categories.

The monitoring of investment counterparties - The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Sector as and when ratings change, and counterparties are checked promptly *{If you do not currently receive the Sector counterparty service please contact us for further information of the service. It will be impossible to meet the requirements unless regular credit ratings are available.*) On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Director of Finance, and if required new counterparties which meet the criteria will be added to the list.

If the Council uses external fund managers, the following could also be added.

Use of external fund managers – It is the Council's policy to use external fund managers for part of its investment portfolio. The fund managers will use both specified and non-specified investment categories, and are contractually committed to keep to the Council's investment strategy. The terms of the fund managers' investment policies are*………(insert).* The performance of each manager is reviewed at least (*monthly/quarterly/semi-annually*) by the Director of Finance and the managers are contractually required to comply with the annual investment strategy (*If fund managers are being used the limits for non-specified investments will need to be set with consideration to the fund managers parameters. Each Council will need to clarify the acceptance of their strategy with each of their managers. Clients may find it helpful to report the split of their internal limits and potential fund manager limits separately, and then combine them for the overall limit.).*

5.5 APPENDIX: Approved countries for investments

Based on lowest available rating

AAA

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

AA+

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

AA

- Abu Dhabi
- Qatar
- UAE

AA-

- Belgium
- Japan
- Saudi Arabia

5.6 APPENDIX: Treasury management scheme of delegation

(i) Full board/council

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

(ii) Boards/committees/council/responsible body

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

(iii) Body/person(s) with responsibility for scrutiny

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

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

The S151 (responsible) officer

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