Treasury Management Strategy 2010/11 – 2012/13

1. The Treasury Management service is an important part of the overall financial management of the Council's affairs. Its importance has increased as a result of the freedoms provided by the Code. It covers the borrowing and investment activities and the effective management of associated risks. Whilst the prudential indicators above consider the affordability and impact of capital expenditure decisions, the treasury management service covers the effective funding of these decisions. There are also specific treasury management prudential indicators included in this strategy which need approval. Together they form part of the process which ensures the Council meets its balanced budget requirement under the Local Government Finance Act 1992

2. The Council's activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management –revised November 2009). This Council adopted the Code of Practice on Treasury Management on 21st March 2002 (Min. Ref. 63/Mar/2002 refers) and will adopt the revised Code at Special Council during February 2010 when the MTFP will be approved.

3. As a result of adopting the Code the Council also adopted a Treasury Management Policy Statement (21/03/2002). This adoption meets the requirements of one of the prudential indicators. However the revised Code of Practice has amended the Treasury Management policy statement and this is appended at Appendix 1 for approval.

4. The Treasury Management Policy requires an annual strategy to be reported to Cabinet/ Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. A further treasury report is produced after the year-end to report on actual activity for the year, and a new requirement of the revised Code of Practice is that there is a mid-year monitoring report, however Cabinet/ Council of this authority have been advised by such a report for a number of years.

5. This Strategy covers:

   (a) The Councils debt and investment projections;
   (b) The Councils estimates and limits on future debt levels;
   (c) The expected movements in interest rates
   (d) The Council's borrowing and investment strategies;
   (e) Treasury Management Performance indicators;
   (f) Specific Limits on Treasury Management activities;
   (g) Any local Treasury Management issues.

Debt and Investment Projections 2010/11 – 2012/13

6. The borrowing requirement comprises of' the expected movement in CFR and any maturing debt which will need to be refinanced. The table 9 below shows this effect on the treasury position over the next three years. The expected

maximum debt position during each year represents the Operational Boundary Prudential Indicator, and will be different from the year end position as it is adjusted to include estimated additional borrowing that may be required to cover Prudential borrowing for formerly leased assets, borrowing under Directors delegated powers and any additional supported borrowing that may be offered throughout the year.

Table - Operational Boundary

	2009/10 Revised	**2010/11 Estimated**	**2011/12 Estimated**	**2012/13 Estimated**
Market/ PWLB debt (Table 5)	85.860	95.860	120.860	125.860
Other Long Term Liabilities under IFRS ie Leases and PFI (Table 4)	26.479	24.939	23.434	21.962
Total External Debt at 1st April	104.242	112.339	120.799	144.294
Expected Change in Debt	8.097	8.460	23.495	3.528
Debt at 31st March	112.339	120.799	144.294	147.822
Add				
Estimated Additional Supported Borrowing	0.500	0.500	0.500	0.500
Prudential Borrowing for leasable assets	1.000	1.000	1.000	1.000
Prudential Borrowing under Directors delegated powers	0.500	0.500	0.500	0.500
Operational Boundary	**114.339**	**122.799**	**146.294**	**149.822**
Investments	39.900	20.000	25.000	37.500
Total Investments at 31 March	20.000	25.000	37.500	50.000
Investment Change	-19.900	5.000	12.500	12.500
Net Borrowing	94.339	97.799	108.794	99.822

Limits to Borrowing Activity

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

8. For the first of these the Councils needs to ensure that its total borrowing net of any investments, does not except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2010/11 and the following two financial years (the relevant comparative figures are highlighted). This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue purposes.

9. Table 5 is repeated below to illustrate this indicator

Net Borrowing to CFR

	2009/10 Revised	**2010/11 Estimate**	**2011/12 Estimate**	**2012/13 Estimate**
	£m	**£m**	**£m**	**£m**
Net Borrowing	65.860	70.860	83.860	75.860
CFR (from Table 4)	140.545	147.639	146.700	142.909

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

11. **The Authorised Limit for External Debt -** A further key prudential indicator represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by 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

12. This is the statutory limit determined under section 3 (1) of the local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although no control has yet been exercised.

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

Table Authorised Limit

	2009/10 Revised	2010/11 Estimate	2011/12 Estimate	2012/13 Estimate
Operational Boundary from table 9	**114.339**	**122.799**	**146.294**	**149.822**
Additional Headroom as a % of Operational Boundary	**10%**	**10%**	**10%**	**10%**
Authorised Limit	**125.772**	**135.079**	**160.923**	**164.804**

14. Borrowing in advance of need – The Council has some flexibility to borrow funds this year for use in future years. The Director of Corporate Services may do this under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. Whilst the Director of Corporate Services will adopt a cautious approach to any such borrowing, where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities. Any borrowing in advance will be made within the following constraints.
    (a) It will be limited to no more than 50% of the expected increase in borrowing need (CFR)over the 3 year planning period; and
    (b) Would not look to borrow more than 6 months in advance of need.

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

Expected movement in Interest Rates

16. There is always a risk to the Treasury Management Budget from adverse movement in interest rates. The Prudential Code is constructed on the basis of affordability, part of which relates to borrowing costs and investment returns. The Council employs Butlers, the treasury consultants, to advise on the Treasury Management Strategy, to provide economic data and interest rate forecasts, to assist planning and reduce unforeseen adverse movements. Butlers view of the UK and world economy and the effects this will have on the UK interest rates is attached at **Appendix 3** Forecast interest rates are summarised in Table 11

Table - Medium Term Rate forecast- Annual Average % (Source Butlers)

Year	Bank Rate	Investment Rates		PWLB Rates *		
		3 Month	**I Year**	**5 Year**	**20 Year**	**50 Year**
2009/10	0.5	0.8	1.4	3.2	4.4	4.6
2010/11	1.0	1.5	2.3	4.0	5.0	5.2
2011/12	2.0	2.5	3.3	4.3	5.3	5.3
2012/13	4.5	4.8	5.3	5.3	5.5	5.3

Borrowing and Debt Strategy 2010/11 -2012/13

17. The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy.

18. Long- term fixed interest rates are at risk of being higher over the medium term, and short term rates are expected to rise, although modestly. The Director of Corporate Services, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time taking into account the risks shown in the forecast above. It is likely that shorter term fixed rates may provide lower cost opportunities in the short/ medium term.

19. With the likelihood of long term rates increasing, debt restructuring is likely to focus on switching from longer term fixed rates to cheaper shorter term debt, although the Director of Corporate Services and treasury consultants will monitor prevailing rates for any opportunities during the year.

20. The option of postponing borrowing and running down investments may continue in the short to medium term. This will continue to reduce counterparty risk whilst hedging against expected low investment returns.

Investment Strategy 2010/11-2012/13

21. **Key Objectives –** The Councils Investment Strategy primary objectives are safeguarding the repayments of the principal and interest of its investments on time first, and ensuring liquidity second, the investment return being the third objective. Following the economic background at present the current investment climate has one over-riding risk consideration, that of counterparty security. As a result of these underlying concerns officers are implementing an operational investment strategy which tightens the controls already in place in the approved investment strategy.

22. **Risk Benchmarking –** A development in the revised Codes and the CLG consultation paper is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are new requirements to Member reporting, although the application of these is more subjective in nature. Additional background in the approach taken is attached at **Appendix 4**

23. These benchmarks are simple targets (not limits) and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current trend position and amend the operational strategy depending on any changes. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual report.

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

0.03% historic risk of default when compared to the whole portfolio. Appendix 4 holds more details on this calculation

25. Liquidity – In respect of this area the Council seeks to maintain:
    (a) Bank overdraft - £0.500m
    (b) Liquid short term deposits of at least £3m available within a weeks notice.
    (c) Weighted Average Life benchmark is expected to be 0.5 years, with a maximum of 1.25 years.
26. Yield - Local measures of yield benchmarks are :
    (a) Investments – Short term – Cashflow investment rates returned against comparative rates
    (b) Investments- Longer term – Capital investments rates returned against comparative average rates
27. And in addition that the security benchmark for each individual year is:

	1 year	2 years	3 years
Maximum	**0.03%**	**0.00%**	**0.00%**

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

28. **Investment Counterparty Selection Criteria -** The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Council will ensure:
    (a) It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections below.
    (b) It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.
29. The Director of Corporate Services will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. This criteria is separate to that which chooses Specified and Non-Specified investments as it provides an overall pool of counterparties considered high quality the Council may use rather than defining what its investments are.

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

recommendation in March 2009 and the CIPFA Treasury Management Code of Practice.

31. Credit rating information is supplied by our treasury consultants on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (potential for change in the longer term) 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.

32. The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) is:
    (a) Banks 1 - Good Credit Quality **–** the Council will only use banks which:
        i. Are UK banks;
    (b) And have, as a minimum, the following Fitch, Moody's and Standard and Poors ratings (where rated):
        i. Short Term **–** F1
        ii. Long Term **–** A-
        iii. Individual / Financial Strength – C (Fitch / Moody's only)
        iv. Support – 3 (Fitch only)
    (c) Banks 2 – Guaranteed UK Banks with suitable Sovereign Support **–** In addition, the Council will use UK banks whose ratings fall below the criteria specified above if all of the following conditions are met:
        i. wholesale deposits in the bank are covered by a government guarantee;
        ii. the Council's investments with the bank are limited to amounts and maturities within the terms of the stipulated guarantee (This would include Northern Rock)
    (d) Banks 3 – Eligible Institutions **-** the organisation is an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008, with the necessary short and long term ratings required in Banks 1 above. These institutions have been subject to suitability checks before inclusion, and have access to HM Treasury liquidity if needed.
    (e) Banks 4 **–** The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
    (f) Building Societies**–** the Council will use all Societies which meet the ratings for banks outlined above. These may be eligible Institutions that have the necessary short and long term ratings
    (g) Money Market Funds **–** AAA
    (h) UK Government
    (i) Local Authorities, Parish Councils etc

33. **Use of additional information other than credit ratings** – Additional requirements under the Code of Practice now 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,equity prices etc.) will be applied to compare the relative security of differing investment counterparties.

34. **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	**Moody's**	**Standard and Poors**	**Money Limit**	**Time limit up to**
Upper limit category	AA	Aa3	AA-	£5M	3 years
Lower limit category	A-	A3	A-	£3M	1 years
Money Market Funds	AAA	Aaa	AAA	£5M	Investments can be recalled at any time
Debt Management Office				Unlimited	6 months
Own bank				£3M	1 year
Local Authorities				£5M	1 year
Guaranteed Organisations				£3M	Terms of the guarantee
Eligible Institutions				£3M	1 year

35. The proposed criteria for Specified and Non-Specified investments are shown in **Appendix 3**
36. In the normal course of the council's cash flow operations it is expected that both Specified and Non-specified investments will be utilised for the control of liquidity as both categories allow for short term investments.

37. The use of longer term instruments (greater than one year from inception to repayment) will fall in the Non-specified investment category. These instruments will only be used where the Council's liquidity requirements are safeguarded. This will also be limited by the longer term investment limits.

38. **Economic Investment Considerations** - Expectations on shorter-term interest rates, on which investment decisions are based, show likelihood of the current 0.5% Bank Rate remaining flat but with the possibility of a rise in mid-2010.

The Council’s investment decisions are based on comparisons between the rises priced into market rates against the Council’s and advisers own forecasts.

39. There is an operational difficulty arising from the current banking crisis. There is currently little value investing longer term as the higher rated institutions which fall into the higher credit criteria do not offer good returns for longer placed investments. Therefore in the near future investment will generally be placed for up to 1 year only. This will provide better security.

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

41. Examples of these restrictions would be the greater use of the Debt Management Deposit Account Facility (DMADF – a Government body which accepts local authority deposits), Money Market Funds, guaranteed deposit facilities and strongly rated institutions offered support by the UK Government.

Sensitivity to Interest Rate Movement

42. Future Council accounts will be required to disclose the impact of risks on the Council’s treasury management activity. Whilst most of the risks facing the treasury management service are addressed elsewhere in this report (credit risk, liquidity risk, market risk, maturity profile risk), the impact of interest rate risk is discussed but not quantified.   The table below highlights the estimated impact of a 1% increase/decrease in all interest rates to the estimated treasury management costs/income for next year. That element of the debt and investment portfolios which are of a longer term, fixed interest rate nature will not be affected by interest rate changes.

£M	**2010/11 Estimated + 1%**	**2010/11 Estimated - 1%**
Revenue Budgets		
Interest on Borrowing	+0.063	-0.063
Related HRA Charge	-0.034	+0.034
Net General Fund Borrowing Cost	+0.029	-0.029
Investment income	+0.200	-0.200

Treasury Management Limits on Activity

43. There are four further treasury activity limits, which were previously prudential indicators. The purpose of these are to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if these are set to be too restrictive they will impair the opportunities to reduce costs/improve performance. The indicators are:

    (a) Upper limits on variable interest rate exposure – This identifies a maximum limit for variable interest rates based upon the debt position net of investments Upper limits on fixed interest rate exposure – Similar to the previous indicator this covers a maximum limit on fixed interest rates.

    (b) 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.

    (c) 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.

44. The Council is asked to approve the limit

	2010/11		**2011/12**		**2012/13**	
	Upper		**Upper**		**Upper**	
Limits on fixed interest rates	**100%**		**100%**		**100%**	
Limits on variable interest rates	**40%**		**40%**		**40%**	
Maturity Structure of fixed interest rate borrowing						
	Lower	**Upper**	**Lower**	**Upper**	**Lower**	**Upper**
Under 12 months	**0%**	**25%**	**0%**	**25%**	**0%**	**25%**
12 months to 2 years	**0%**	**40%**	**0%**	**40%**	**0%**	**40%**
2 years to 5 years	**0%**	**60%**	**0%**	**60%**	**0%**	**60%**
5 years to 10 years	**0%**	**80%**	**0%**	**80%**	**0%**	**80%**
10 years and above	**0%**	**100%**	**0%**	**100%**	**0%**	**100%**
Maximum principal sums invested greater than 364 days	**£10M**		**£10M**		**£15M**	

Performance Indicators

45. The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. Examples of performance indicators often used for the treasury function are:

    (a) Debt – Borrowing – Average overall interest rate paid compared with previous years
    (b) Investments – Short Term- cashflow investment rate returned against comparative interest rates
    (c) Investments – Longer term – capital investment rates returned against comparative average rates

46. The results of these indicators will be reported in the Treasury Management Half Yearly Review and Annual Reports for 2010/11.

Treasury Management Advisers

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

    (a) Technical support on treasury matters, capital finance issues and the drafting of Member reports;

    (b) Economic and interest rate analysis;

    (c) Debt services which includes advice on the timing of borrowing;

    (d) Debt rescheduling advice surrounding the existing portfolio;

    (e) Generic investment advice on interest rates, timing and investment instruments;

    (f) Credit ratings from the three main rating agencies and other market information on counterparties.

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

Member and Officer Training

49. The increased Member consideration of treasury management matters and the need to ensure officers dealing with treasury management are trained and kept up to date requires a suitable training process for Members and officers. This Council has addressed this important issue by:

    (a) Two training sessions were developed in Late November /Early December 2009 for all members but with a special emphasis for the Audit Committee These outlined the processes involved in compilation of the Treasury Management Strategy. The courses were well attended by the relevant members and well received.

Appendix 1

Treasury Management Clauses to form part of Financial Procedure Rules/Constitution

1. This Council will create and maintain, as the cornerstones for effective treasury management:
   (a) A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities;
   (b) Suitable Treasury Management Practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.
2. The Council will receive reports on its treasury management policies, practices and activities, including as a minimum, an annual strategy and plan in advance of the year, a mid year review and an annual report after its close, in the form prescribed in its TMPs.
3. The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to the Cabinet, and for the execution and administration of treasury management decisions to the Director of Corporate Services, who will act in accordance with the Council's policy statement and TMPs and CIPFA's Standard of Professional Practice on Treasury Management.
4. The organisation nominates Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

Appendix 2

Security, Liquidity and Yield Benchmarking

Benchmarking and Monitoring Security, Liquidity and Yield in the Investment Service

2. A proposed development for Member reporting is the consideration and approval of security and liquidity benchmarks.

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

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

   (a) Investments – Short Term- cashflow investment rate returned against comparative interest rates
   (b) Investments – Longer term – capital investment rates returned against comparative average rates

5. Security and liquidity benchmarks are already intrinsic to the approved treasury strategy through the counterparty selection criteria and some of the prudential indicators. However they have not previously been separately and explicitly set out for Member consideration. Proposed benchmarks for the cash type investments are below and these will form the basis of future reporting in this area. In the other investment categories appropriate benchmarks will be used where available.

6. Liquidity – This is defined as "having adequate, though not excessive cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives" (CIPFA Treasury Management Code of Practice). In respect of this area the Council seeks to maintain:

   (a) Bank overdraft - £0.500M
   (b) Liquid short term deposits of at least £3M available with a week's notice.

7. The availability of liquidity and the term risk in the portfolio can be benchmarked by the monitoring of the Weighted Average Life (WAL) of the portfolio – shorter WAL would generally embody less risk. In this respect the proposed benchmark is to be used:

   WAL benchmark is expected to be 0.5 years, with a maximum of 1.25 years.

8. Security of the investments – In context of benchmarking, assessing security is a much more subjective area to assess. Security is currently evidenced by the application of minimum credit quality criteria to investment counterparties, primarily through the use of credit ratings supplied by the three main credit rating agencies (Fitch, Moody's and Standard and Poors). Whilst this approach embodies security considerations, benchmarking levels of risk is more problematic. One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council's investment strategy. The table beneath shows average defaults for differing periods of

investment grade products for each Fitch long term rating category over the period 1990 to 2007.

Long term rating	1 year	2 years	3 years	4 years	5 years
AAA	**0.00%**	**0.00%**	**0.00%**	**0.00%**	**0.00%**
AA	**0.00%**	**0.00%**	**0.00%**	**0.03%**	**0.06%**
A	**0.03%**	**0.15%**	**0.30%**	**0.44%**	**0.65%**
BBB	**0.24%**	**0.78%**	**1.48%**	**2.24%**	**3.11%**

9. The Council's minimum long term rating criteria is currently "A-" , meaning the average expectation of default for a one year investment in a counterparty with a "A-" long term rating would be 0.03% of the total investment (e.g. for a £1m investment the average loss would be £300). This is only an average - any specific counterparty loss is likely to be higher - but these figures do act as a proxy benchmark for risk across the portfolio.

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

0.03% historic risk of default when compared to the whole portfolio.

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

	1 year	2 years	3 years
Maximum	**0.03%**	**0.15%**	**0.00%**

These benchmarks are embodied in the criteria for selecting cash investment counterparties and these will be monitored and reported to Members in the Investment Annual Report. As this data is collated, trends and analysis will be collected and reported. Where a counterparty is not credit rated a proxy rating will be applied.

Appendix3

Treasury Management Practice (TMP) 1 (5) – Credit and Counterparty Risk

Management

1. The Office of the Deputy Prime Minister (now CLG) issued Investment Guidance on 12th March 2004, and this forms the structure of the Council's policy below. The CLG is currently consulting over revisions to the Guidance and where applicable the Consultation recommendations have been included within this policy. These guidelines do not apply to either trust funds or pension funds which are under a different regulatory regime.

2. 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 21st March 2002 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 –

3. 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:

   (a) The strategy guidelines for choosing and placing investments, particularly non-specified investments.
   (b) The principles to be used to determine the maximum periods for which funds can be committed.
   (c) Specified investments the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
   (d) 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.

4. The investment policy proposed for the Council is:

Strategy Guidelines –

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

Specified Investments –

6. 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:

   (a) The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
   (b) Supranational bonds of less than one year's duration.
   (c) A local authority, parish council or community council.
   (d) Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category d this covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's or Fitch rating agencies.
   (e) A body that is considered of a high credit quality (such as a bank or building society). For category e this covers bodies with a minimum short term rating of F1 (or the equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies.

7. 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

Non-Specified Investments –

8. Non-specified investments are any other type of investment (i.e. not defined as Specified above).

	Non Specified Investment Category	**Limit (£ or %)**
a.	**Eligible Institutions** - the organisation is an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008, with the necessary short and long term ratings required in Banks 1 above (see Paragraph 71 in main report) These institutions have been subject to suitability checks before inclusion, and have access to HM Treasury liquidity if needed.	50%
b.	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.	£3M
c.	Any **bank or building society** that has a minimum long term credit rating of AA-, for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	£10M

9. The table below shows the minimum credit rating for inclusion on the Council counterparty list

Table 1

	Fitch				Moody's		
Type	**Short Term**	**Long Term**	**Ind.**	**Support**	**Short Term**	**Long Term**	**Financial Strength**
UK Bank	F1	A-	C	3			
MMF	AAA				AAA		
DMADF	-				-		
UK Building Society (1)					P-1	A3	C
Eligible Institutions	F1	A-	-		P-1-	A3-	-
Guaranteed Organisations							

10. Table 2 shows investment time and money limits categorised between specified and non specified investments

Table 2

	Fitch				Moody's				
Type	**Short Term**	**Long Term**	**Ind**	**Support**	**Short Term**	**Long Term**	**Financial Strength**	**Time Limit**	**Money limit**
UKBank / Building Society	F1	A-	-	-	P-1			1 year	£5m
MMF	AAA							Call	£5m
DMADF	-				-			6 months	Unlimited
Guaranteed Organisations								Term of Guarantee	£3m
Eligible Institutions								1 year	£3m
Long term UK Bank / BS	F1	AA-	C	3	P-1	A3	C	3 years	£5m

The Monitoring of Investment Counterparties –

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