Treasury Management Strategy 2012/13 – 2014/15

1. The treasury management service is an important part of the overall financial management of the council's affairs. The prudential indicators in the council's annual budget setting report consider the affordability and impact of capital expenditure decisions, and set out the council's overall capital framework. The treasury service considers the effective funding of these decisions. 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 treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management – revised 2011).

3. As a part of the Code the council also adopted a Treasury Management Policy Statement. This adoption is required as one of the prudential indicators.

4. The policy requires an annual strategy to be reported to Council outlining the expected treasury activity for the forthcoming three years. A key requirement of this report is to explain the risks, and the management of those risks, associated with the providing the treasury service. Legislation requires that two further treasury reports are required: a mid-year monitoring report and an outturn report after the year-end that reports on actual activity for the year.

5. This strategy covers:
   - the Council's debt and investment projections;
   - the expected movement in interest rates;
   - the Council's borrowing and investment strategies;
   - treasury performance indicators;
   - specific limits on treasury activities;
   - any local treasury issues.

Debt and Investment Projections 2012/13 – 2014/15

6. The council has to provide details of its borrowing requirement, any maturing debt which will need to be re-financed, and the effect this will have on the treasury position over the next three years. This council has no external debt and doesn't expect to borrow long term to finance its capital programme. There may be occasions when we need to borrow short-term for temporary cash flow reasons; these liabilities are likely to be for fixed rates and terms. The table therefore only specifies the limits for any temporary short-term borrowing and highlights the expected change in investment balances.

Limits to borrowing activity

	2011/12 Revised	2012/13 Estimated	2013/14 Estimated	2014/15 Estimated
External Debt				
Operational boundary	£2 million	£2 million	£2 million	£2 million
Authorised limit	£5 million	£5 million	£5 million	£5 million
Limit at variable interest rates	nil	nil	nil	nil
Limit for maturity > 1 year	nil	nil	nil	nil

The **operational boundary** is the limit which external borrowing is not normally expected to exceed. The **authorised limit** is a control on the maximum level of borrowing - a limit beyond which external borrowing is prohibited. This limit can only be set or revised by a meeting of the full Council. This is aimed at authorities with long-term borrowing and is meant to reflect the level of borrowing that would not be sustainable long term.

Projected total investments

	2011/12 Revised	2012/13 Estimated	2013/14 Estimated	2014/15 Estimated
Investments				
Total Investments at 31 March	£13 million	£14.5 million	£15 million	£15 million

The following information and commentary has been provided by Sector, the council's investment consultants.

Expected Movement in Interest Rates

Medium term interest rate estimates (mid year)
(source: Sector Treasury Ltd)

	Bank of England base rate	Estimated earnings rates for investments up to 3 months duration	DMO PWLB rates (borrowing)		
			5 yr	10 yr	50 yr
2012/13	0.50%	0.70%	2.30%	3.40%	4.40%
2013/14	0.75%	1.00%	2.70%	3.70%	4.70%
2014/15	2.00%	1.60%	3.30%	4.40%	5.10%

7. The UK economy is expected to experience weak growth in the next two years and there is a real risk of a technical recession (two quarters of negative growth). The Bank of England (BoE) base rate underpins investment returns and this is not expected to start increasing from its current rate of 0.5% until the third quarter (September) of 2013 despite the prevailing rate of inflation currently being above the target for the BoE Monetary Policy Committee. Previous hopes for an export-led recovery now appear unlikely due to the continuing Eurozone sovereign debt crisis depressing growth in the UK's biggest export market. The Government's four-year Comprehensive Spending Review, which seeks to reduce the UK's annual fiscal deficit, is also likely to depress growth during the next few years.

8. This challenging and uncertain economic outlook has the following implications:
   - The Eurozone sovereign debt difficulties provide a clear indication of much higher counterparty risk. This therefore suggests the continued use of high quality counterparties and for shorter time periods;
   - Investment returns are likely to remain relatively low during 2012/13;

Investment Strategy 2012/13 – 2014/15

9. Key Objectives. The council's primary investment strategy objectives are firstly safeguarding the repayment of the principal and interest of its investments on time and secondly ensuring adequate liquidity – the investment return being a third objective. As a result of the economic situation highlighted above, the current investment climate has one over-riding risk consideration: that of counterparty security risk. Consequently officers will continue to implement an operational

investment strategy which further tightens the controls already in place in the approved investment strategy.

10. Risk Benchmarking. An addition to 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 for member reporting, although the application of these is more subjective in nature. Additional background information and an explanation of the approach taken is provided at Annex A2 to this appendix.

11. These benchmarks are basic targets (not limits) and so may be missed from time to time as a result of movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers can monitor the current and 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 and/or Annual Report.

12. Security. The council's maximum security risk benchmark for the current portfolio, when compared to the historic default tables in Annex A2, is:

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

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

13. Liquidity. In respect of this area the council seeks to maintain:

- Bank overdraft – the aim is not to use bank overdraft but if necessary the limit would never exceed the limit for external debt as shown in para 6 to this appendix;
- Liquid short term deposits of at least £0.5m available the next day;
- Weighted Average Life benchmark target is **91** days, with a maximum of **360** days.

14. Yield. The local measures of yield benchmarks are:

- Investments – Internal returns above the London Interbank Bid (LIBID) 7-day rate;
- Investments – External fund managers - returns 110% above 7 day compounded LIBID.

15. 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 also ensure:

- It maintains a policy covering the categories of investment types (specified and non-specified) it will invest in; the criteria for choosing investment counterparties with adequate security, and monitoring their security. Details of the two categories of specified and non-specified investments are set out in more detail in the relevant sections of Annex A1 to this appendix.
- 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 (see para 22 below). These procedures also apply to the council's prudential indicators covering the maximum principal sums invested.

16. The chief financial officer 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 different from that which determines specified and non-specified investments as it selects which counterparties the council may use rather than defining what its investments are.

17. 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.

18. 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), and 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.

19. 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 AAA

  And have, as a minimum, the following Fitch, Moody's and Standard and Poor's credit ratings (where rated):

    i. **Short Term** - F1 P-1 A-1
    ii. **Long Term** – A- A3 A-
    iii. **Individual** / **Financial Strength** – C (Fitch / Moody's only)
    iv. **Support** – 3 (Fitch only)

- **Banks 2 –** Part nationalised UK banks – Lloyds Bank and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.

- **Banks 3** – In exceptional circumstances and for transactional purposes, the council's own banker, if the bank falls below the above criteria, and balances will be minimised in both monetary size and time. This is a last resort and will be used only if there are a lack of suitable counterparties or if the cost of placing an investment (due to the requirement for cash-flow liquidity) exceeds the return (for example – short-term investments of a minimal amount). To limit the council's exposure to default, the amount will be kept as low as possible and the period of deposit will be until the next bank working day.

- **Bank Subsidiary and Treasury Operations** – the council will use these where the parent bank (with the necessary rating) has provided an appropriate guarantee or the subsidiary has the necessary ratings outlined above.

- **Building Societies** – the council will use mutual societies which:
    i. meet the ratings for banks outlined above, or
    ii. have assets in excess of £500 million.
- **Money Market Funds** – AAA
- **UK Government** (including gilts and the Debt Management Deposit Account Facility (DMADF))
- **Local Authorities, Parish Councils etc**
- **Supranational institutions**

20. **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 25% will be placed with any non-UK country at any time;
- limits in place above will apply to Group companies;
- Sector limits will be monitored regularly for appropriateness.

21. **Use of additional information other than credit ratings** – Additional criteria 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, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

22. **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 & Poor's	Money limit	Time limit
Upper Limit Category	F1+/AA-	P-1/Aa3	A-1+/AA-	£5m	3 years
Lower Limit Category	F1/A-	P-1/A3	A-1/A-	£5m	1 years
Unrated Limit Category	-	-	-	£3m	6 months
Council's banker not meeting Banks 1	n/a	n/a	n/a	minimal - not to exceed £3m	to next banking day
Other Institution Limits	-	-	-	£5m	various
Part nationalised	-	-	-	£5m	3 years

(The upper and lower limit categories will include banks and rated building societies. The unrated limit category will normally be used for unrated subsidiaries and unrated building societies. 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 have the same limit as the upper category. Guaranteed institutions will need to be restricted to the terms of the guarantee.)

In exceptional circumstances short term variations to these limits will be allowed, subject to the written authority of the chief financial officer.

23. The proposed criteria for specified and non-specified investments are shown in Annex A1.

24. All our investments will fall in within definition of either specified and non-specified investments (see Annex A1); in the normal course of the council's cash flow operations it is expected that both types will be utilised for the control of liquidity as both categories allow for short term investments.

25. The use of longer term instruments (greater than one year from inception to repayment) will fall in the non-specified investment category. Whenever these instruments are to be used, consideration will be taken to ensure the council's liquidity requirements are safeguarded. These will also be limited by the longer term investment limits.

26. **Economic Investment Considerations** - Expectations of short-term interest rates, on which investment decisions are based, indicate that the current 0.5% BoE base rate will remain flat for some considerable time. The council's investment decisions regarding duration of investment are based on comparisons between the rises priced into market rates and the forecasts of the council and its advisers.

27. The current sovereign and banking crises presents a significant operational difficulty. There is currently little value investing longer term unless credit quality is reduced. Whilst some selective options do provide a higher return, uncertainty over counterparty creditworthiness and sustainability suggests that shorter dated investments provide better security. Wherever possible, use will be made of 'special local authority' rates offered by some of the part-nationalised banks.

28. **The criteria for choosing counterparties set out above provide a sound approach to investment in "normal" market circumstances. Whilst members are asked to approve the base criteria above, under the exceptional current market conditions the chief financial officer 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 or the chief financial officer lifts any restriction. Similarly the duration of any investments may be restricted.**

29. A consequence 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. The credit criteria have been amended to reflect these facilities. Use of more secure facilities would have a detrimental effect on the level of return.

Treasury Management Prudential Indicators and Limits on Activity

30. Further to the indicators above, there are four other treasury prudential indicators. The purpose of these prudential indicators is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if these are set to be too restrictive they will impair the opportunities to generate income. Currently, as the council has no long term debt, these indicators apply only to investments. They are:

- Upper limits on variable interest rate exposure. Due to the minimal levels of investments held by the council there has not been a need to use period investments at variable interest rates. The council holds an instant access bank deposit account ('call' account) which is available for "overnight" investment. The interest rate on this account is reviewed every week by the bank but we could move our funds at any time. The council also uses a Money Market Fund for instant access. The rate is notified daily and again the funds can be moved at any time. Both these accounts are used more for cash-flow liquidity purposes rather than investment vehicles.
- Upper limits on fixed interest rate exposure. Similar to the previous indicator this covers a maximum limit on fixed interest rates.
- Maturity structures of borrowing. These gross limits are set to reduce the council's exposure to large fixed rate sums falling due for refinancing. As previously stated this does not apply here.
- Total principal funds invested for greater than 364 days. These limits are set to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

These limits, which include cash held by the Fund Manager, are higher than the council's actual total funds because cash received during the year is invested until it is required to be paid over to the Government or precepting bodies.

31. The Council is asked to approve the following prudential indicators:

£m	2012/13	2013/14	2014/15
Interest rate exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates: • Debt only • Investments only	nil £50 million	nil £50 million	nil £50 million
Limits on variable interest rates • Debt only • Investments only	nil £10 million	nil £10 million	nil £10 million
Maturity structure of fixed interest rate borrowing 2011/12 – not applicable			
Maximum principal sums invested > 364 days			
Principal sums invested > 364 days	£20 million	£20 million	£20 million

Performance Indicators

32. 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 performance indicators, as opposed to the predominantly forward looking prudential indicators. Examples of performance indicators used to assess the performance of the treasury function are:

- Investment returns above the 7-day LIBID rate (in-house, 110% Fund Manager).
- Investment returns compared to similar local authority funds (Fund Manager only). Target is to be in the top quartile.
- Maximum investment of daily balances (in-house).
- Maintenance of a balanced portfolio.

The results of these indicators will be reported in both the annual mid-year and year-end treasury reports.

Treasury Management Consultants

33. The council uses Sector Treasury Ltd (known as ‘Sector’) as its treasury management consultants, in a joint agreement with SODC. The company provides a range of services which include:

- technical support on treasury matters, capital finance issues and the drafting of member reports;
- economic forecasts and interest rate analysis;
- generic investment advice on interest rates, timing and investment instruments;
- credit ratings/market information service involving the three main credit rating agencies.

Following the collapse of the Icelandic banks, and the subsequent local authority exposure to these defaults, the latest revision to the CLG investment guidance notes and the CIPFA Treasury Code of Practice requires the council to recognise **that responsibility for treasury management decisions remains with the council at all times** and to ensure that undue reliance is not placed upon 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.

Member and Officer Training

34. 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. If a requirement is identified, then training for members and officers will be made available as suitable opportunities arise.

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

The CLG issued Investment Guidance in 2010, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds which are 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 has adopted the Code and will apply its principles to all investment activity. 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 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 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) and not defined as capital expenditure (making an investment in a company). These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include investments 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. (AAA or equivalent).
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). This covers bodies with a minimum short term rating of F1+ (Fitch, or the equivalent).

Within these criteria, and in accordance with the Code, the council has additional measures to set the time and amount of monies which will be invested in any one body (including its subsidiaries). These limits are £5 million and 3 years.

Non-Specified Investments. Non-specified investments are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Bonds and gilt-edged securities are included for the benefit of the council's Fund Manager. Non specified investments would include any sterling investments 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, and 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 rating. Any one name up to 20% of the value of the fund
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. Average duration of investments for funds should not exceed 5 years.	Maximum proportion of fund invested for longer than 1 year not to exceed 60%
c	**The Council's own bank** if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.	minimal
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 are Eligible Institutions and have a minimum asset size of £1 billion restricted to 1 year, and minimum asset size £500 million restricted to 6 months.	£3 million
e	Any **bank or building society** that has a minimum long term credit rating of AA- or equivalent, for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	50%
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 a guarantee from the parent	£3 million

	company, and a maximum period of investment of 6 months	
g	**Share capital or loan capital*** in a body corporate – The use of these instruments is 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	**Pooled property or bond 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. Revenue resources will not be invested in corporate bodies.	

*In respect of categories 'g' and 'h', these will only be considered after obtaining external advice and subsequent Member approval.

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 rates change or outlook forecasts are revised, 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 and any new counterparties which now meet the criteria will be added to the list. As most of our placements with counterparties are in the form of fixed term deposits, it is not possible to curtail a deposit until it has reached maturity. This does however normally confer priority creditor status on the council in the case of default.

Use of External Fund Managers. It is the Council's policy to use an external fund manager for part of its investment portfolio. The fund manager will use both specified and non-specified investment categories, and is required to comply with the council's investment strategy. The council receives monthly activity reports. Sector also monitor and report on the performance of the manager quarterly and the annual performance of the fund manager is reported to Council in the annual report on the performance of cash investments at the end of the financial year.

The current fund manager is Investec. The funds invested with the fund manager are non-working capital (ie: funds that are not required on a regular basis to meet the council's operational requirements). The balance held is generally in excess of £10 million in order to take advantage of better percentage rates for management charges.

Security, Liquidity and Yield Benchmarking

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

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

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

Yield. The local benchmark currently used to assess the performance of investments for the in-house team and the fund manager is the level of returns contrasted against the London Interbank Bid (LIBID) 7-day rate. This is the interest rate a bank would be willing to pay to borrow from another bank for seven days.

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

Much of the CLG and CIPFA guidance is aimed at a relatively large authority with both borrowing and investments spread over a number of years. As an indication of this, worked examples from Sector assume investments of £50 million spread over 5 years.

Liquidity. Liquidity is defined as the council “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). The in-house team keeps a daily cash-flow forecast and would only have an unseen requirement if (for example) a large receipt was received later than expected. In such a scenario, short term borrowing would be considered to cover the period of delay. In respect of this area the Council seeks to maintain:

- Bank overdraft – there is no routine overdraft facility but in an emergency we could overdraw with our transactional bankers for a short period.
- Liquid short term deposits of at least £500,000 available on instant access.

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 – a shorter WAL would generally embody less risk. In this respect the proposed benchmark is to be used:

- WAL benchmark is expected to be **91** days, with a maximum of **360** days**.**

Security of the investments. In the context of benchmarking, assessing security is very much more a 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 Poor’s). 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.

Average defaults for differing periods of investment

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%

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 an "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. As mentioned above, the in-house team rarely make an investment in excess of 1 year and most are considerably shorter. Further development of this approach is required to see if this methodology is suitable for a portfolio of mostly short-term investments.

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. (i.e. equivalent to £300 on £1 million)

These benchmarks are embodied in the criteria for selecting cash investment counterparties and these will be monitored and reported to members in the both the Investment Mid-Year report and 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.

Property Investment Policy

1.0 The case for property

1.1 The Council is restricted in the different investment vehicles it is legally allowed to invest in notwithstanding the over-riding need for prudence mentioned earlier. Of the few avenues open one is property and the returns from investing in property have generally been, and currently are, greater than the limited opportunities in the money markets.

1.2 In broad terms the returns are greater because the risks are greater. Factors to be taken into account when deciding the principle of investing in property include:

- investment will be for the long term since it may not be possible, or wise, to sell quickly,
- the costs of acquisition and disposal are higher,
- there are management costs, risk of rent default and failure to honour maintenance agreements,
- different types of property and different areas carry different risks,
- generally property tends to appreciate in value, although this will vary by type and area; however, in some cases the value may go down,
- property can become functionally obsolete necessitating major refurbishment,
- without regular repair and maintenance the condition will deteriorate and the responsibility for repairs/maintenance may not always rest with the tenant,
- certain types of property may become less desirable as time goes by; this can make re-letting difficult or attract a lower calibre of tenant.

2.0 How much to invest?

2.1 The in-house cash holdings are currently adequate for cash-flow management purposes (operational capital). Currently, that means there is £15 million invested through the fund manager and £34 million invested in property (a total of £49 million invested). The investment in property currently represents 69% of this figure.

Policy 1. The maximum percentage of the investment portfolio in property should be 80% of the total, and the cash funds invested (i.e. not held for cash-flow purposes) should not fall below £5 million.

3.0 What type of property?

3.1 There are different types of property investment with assessment of prospects as follows:

i)	shops and offices	good - although may be subject to changing fashions and working practices
ii)	industrial	good but condition can be variable
iii)	leisure	good but may be best avoided since too close to our “core” business
iv)	agricultural	moderate but too risky now
v)	woodland	poor – some is owned for environmental/leisure purposes

3.2 Average Yield Levels (%). In general, property can be categorised as prime, secondary or tertiary in terms of its desirability. ‘Rack-rented’ means that the maximum market rental achievable is being received. Yield derives from both capital and rent. Lower yields can indicate that the investment attracts a lower degree of risk due to the ratio of rent to capital and other factors such as location, security and regularity of income.

Policy 2. In general, properties for investment will be from the categories: retail, offices, industrial land and buildings.

4.0 Where should it be located?

4.1 There are compelling legal, cultural and financial reasons for not investing in the European mainland at the moment. Within the UK the location will influence the return and the type of property and may make management more or less difficult depending on distance from the Council offices.

Policy 3. **Only property located in the UK will be considered.**

5.0 What level of financial return?

5.1 As mentioned above, generally the greater the return, the greater the risk inherent in the investment. There are so many variables involving area, management, condition, leases and the varying return on other investments that it is difficult to draw up hard and fast rules about them and their relationship with the rate of return.

Policy 4. With regard to the rate of return, each proposal will be considered on its merits.

6.0 Review

6.1 The Policy to be reviewed annually (along with the Treasury Management Strategy).