Executive

5 February 2010

Report of **Head of Finance**

Author: **Steve Lawrence**

Telephone: **01235 540321**

E-mail: **steve.lawrence@whitehorsedc.gov.uk**

Executive Portfolio Holder: **Councillor Jerry Patterson**

Telephone: **01865 730588**

E-mail: **jerry.patterson@whitehorsedc.gov.uk**

Report No. 102/09

Wards Affected
None.

Treasury Management and Investment Strategy 2010/11 to 2012/13

Recommendations

The Executive is recommended to approve each of the following key elements of this report, and recommend these to Council:

a) The Treasury Management Strategy 2010/11 to 2012/13, and the treasury Prudential Indicators contained within Appendix A (paragraph 36).

b) The Authorised Limit Prudential Indicator as shown in paragraph 6 of the strategy.

c) The Investment Strategy 2010/11 contained in the treasury management strategy (Appendix A), and the detailed criteria included in Annex A1.

d) The revision to the Council's Financial Regulations as at Annex A3 and consequential amendments to the constitution. This nominates the Audit and Governance Committee to ensure effective scrutiny of the treasury management strategy and policies.

Purpose of Report

1. This report outlines the council's Treasury Management prudential indicators for 2010/11 and sets out the expected treasury operations for this period. It fulfils four key legislative requirements:

- The reporting of the **prudential indicators** setting out the expected capital activities (as required by the CIPFA Prudential Code for Capital Finance in Local Authorities) forms part of the budget proposal considered at the Council meeting in February. The treasury management prudential indicators are now included as treasury indicators in the CIPFA Treasury Management Code of Practice;

- If the council borrowed to fund capital expenditure it would need a **Minimum Revenue Provision (MRP) Policy**, which sets out how the council will pay for capital assets through revenue each year. This is not applicable to this council at the moment but if it was, a report would be brought forward prior to the year in which it would happen; (as required by Regulation under the Local Government and Public Involvement in Health Act 2007);
- The **treasury management strategy statement** which sets out how the council's treasury service will support the capital decisions taken in the budget report, the day to day treasury management and the limitations on activity through treasury prudential indicators. The key indicator is the **Authorised Limit**, the maximum amount of debt the council could afford in the short term, but which would not be sustainable in the longer term. This is the Affordable Borrowing Limit required by s3 of the Local Government Act 2003. This is in accordance with the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code and shown at Appendix A;
- The **investment strategy** which sets out the council's criteria for choosing investment counterparties and limiting exposure to the risk of loss. This strategy is in accordance with the CLG Investment Guidance and also shown in Appendix A.

Relationship with Corporate Plan

2. The report contributes to the Strategic Objective of managing our business effectively by providing value for money services that meet the needs of our residents and service users.

Background

Local Government Investments

3. Local Authorities' powers and practices for investing their surplus funds are contained in Part 1 of the *Local Government Act 2003.* The act allows the Secretary of State to issue guidance on investments and to specify other guidance which should be followed. Guidance was issued in March 2004 and specified that regard should also be had to the *Treasury Management Code of Practice* and *The Prudential Code for Capital Finance* issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

4. Revised editions of the CIPFA Prudential Code and CIPFA Treasury Management Code of Practice were produced in November 2009. The CLG is currently consulting on changes to the Investment Guidance. The revised guidance arising from these Codes has been incorporated within these reports, with the CLG proposals being incorporated where these do not conflict with current Guidance. If necessary the Investment Strategy contained in Appendix A will be revised if any elements of the final CLG Investment Guidance have not already been covered.

5. The general objective remains that local authorities should prudently invest surplus funds held. Priority should be given to security and liquidity but it is reasonable to seek the highest return consistent with those aims. The guidance specifically discourages the use of speculative investments such as equities. Borrowing to invest remains unlawful.

6. The guidance also applies to investments made through external fund managers.

<u>Treasury Management and Investment Strategy</u>

7. The legislation requires an annual Treasury Management & Investment Strategy Statement. This sets borrowing limits, investment objectives, approved organisations for investment, guidelines and performance criteria for the in-house operation.

8. The main changes initiated in the revisions above increase the Members' responsibility in this area. This would require greater Member scrutiny of the treasury policies, increased Member training and awareness and greater frequency of information. Other changes included in the revised guidance, such as using additional information to support the use of credit ratings, are already in place. The limits and criteria in the current year's strategy have proved suitable and there are no major changes proposed.

9. One element of the revised CIPFA Treasury Management Code of Practice is that the **clauses to be adopted** as part of the council's Financial Regulations be amended. This revision is shown at Annex A3 for approval. The key change is that a responsible body (committee, board or group) be responsible for ensuring effective scrutiny of the treasury management strategy and policies, before making recommendations to Council.

10. The above policies and parameters provide an approved framework within which the officers undertake the day to day capital and treasury activities.

Options

11. There are no alternative options put forward. The council is legally required to agree a strategy. The strategy proposed has been produced in consultation with Butlers (the council's investment advisers) as complying with the regulations and meeting the council's operational requirements.

Financial, legal and any other implications

12. The report gives financial information to help Members manage their services. There is no additional expenditure involved.

Conclusion

13. Members are asked to review the Treasury Management and Investment Strategy and the indicators included and recommend its approval to Council. They are also asked to recommend the revision to Financial Regulations, in accordance with CIPFA Code of Practice, which would nominate the Audit and Governance Committee to be responsible in future for scrutinising treasury management strategy and policies.

Background Papers:
CIPFA – Code of Practice on Treasury Management. (Revised. Pub. 27.11.09)
CLG – Guidance on Local Government Investments. (Draft for consultation pub. 16.11.09)
Butlers – Capital Watch information sheet published 11 December 2009

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. The prudential indicators in the budget 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 November 2009). This council adopted the Code of Practice on Treasury Management in March 2002, and will adopt the revised Code.

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. However the revised Code of Practice has amended the Treasury Management Policy Statement and this is appended at Annex A3 for approval.

4. The policy requires an annual strategy to be reported to 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 the policy requires a mid-year monitoring report which is now included in the revised Code of Practice.

5. This strategy covers:

- The Council's debt and investment projections;
- The Council's estimates and limits on future debt levels;
- 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 2010/11 – 2012/13

6. The council has to detail 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 except temporarily for cash flow purposes. The table therefore only specifies the limits for any likely temporary borrowing and highlights the expected change in investment balances.

	2009/10 Revised	2010/11 Estimated	2011/12 Estimated	2012/13 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
Investments				
Total Investments at 31 March	£15 million	£14 million	£13 million	£12 million

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

Expected Movement in Interest Rates

Medium-Term Rate Estimates (averages)

Annual Average %	Bank Rate	Money Rates		PWLB Rates*		
		3 month	1 year	5 year	20 year	50 year
2008/09	3.9	5.0	5.3	4.2	4.8	4.5
2009/10	0.5	0.8	1.4	3.2	4.4	4.6
2010/11	1.0	1.5	2.6	4.0	5.0	5.2
2011/12	2.0	2.5	3.3	4.3	5.3	5.3
2012/13	4.5	4.8	5.3	5.3	5.5	5.3

* Borrowing Rates

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

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

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

10. The MPC will continue to promote easy credit conditions via QE. QE has been extended to a total of £200bn and there is still an outside chance that it could be expanded further in February. Whether this has much impact in the near term remains a moot point given the personal sector's reluctance to take on more debt and add to its already unhealthy balance sheet.

11. With inflation set to remain subdued in the next few years, the pressure upon the MPC to raise interest rates will remain moderate. Some increase will be seen as necessary in 2010 to counter the effects of external cost pressures (as commodity prices begin to rise again) and to avoid damage that sterling could endure if the UK is seen to defy an international move to commence policy exit strategies.

12. Longer term rates are expected to be more volatile. The current 'softness' of gilt yields & PWLB rates may continue for a while yet, given that these are being driven by a benign international backdrop and the effects of QE. Nevertheless this process

will come to an end before the close of the financial year. This is likely to herald a return to rising yields for a number of reasons:

- Net gilt issuance will rise sharply;
- This will be increased by the extent to which the BoE attempts to claw back funds injected to the economy via the QE programme;
- Investors will be looking to place more of their funds in alternative instruments as their risk appetite increases, demand for gilts will weaken as a consequence;
- A decision to leave QE in place will generate inflation concerns and pressurise long yields higher.

The market/BoE is in a lose/lose situation.

Investment Strategy 2010/11 – 2012/13

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

14. **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 for Member reporting, although the application of these is more subjective in nature. Additional background in the approach taken is attached at Annex A2.

15. 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 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 or Annual Report.

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

    - 0.02% historic risk of default when compared to the whole portfolio.

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

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

    - Bank overdraft – little used. Limits the same as external debt;
    - Liquid short term deposits of at least £0.5m available the next day;
    - Weighted Average Life benchmark is expected to be 21 days, with a maximum of 182 days.

18. Yield - Local measures of yield benchmarks are:

- Investments – Internal returns above the 7 day LIBID rate;
- Investments – External fund managers - returns 110% above 7 day compounded LIBID.

19. **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:
    - 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.
    - 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.

20. The Strategic Director 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 from that which chooses Specified and Non-Specified investments as it selects which counterparties the council may use rather than defining what its investments are.

21. 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.

22. 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.

23. 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 – Guaranteed Banks with suitable Sovereign Support** – In addition, the council will use banks whose ratings fall below the criteria specified above if all of the following conditions are met:
  - (a) wholesale deposits in the bank are covered by a government guarantee;
  - (b) the government providing the guarantee is rated "AAA" by all three major rating agencies (Fitch, Moody's and Standard & Poor's); and
  - (c) the council's investments with the bank are limited to amounts and maturities within the terms of the stipulated guarantee.
- **Banks 3 – Eligible Institutions** - the organisation is an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008, with the necessary short and long term ratings required in Banks 1 above. These institutions have been subject to suitability checks before inclusion, and have access to HM Treasury liquidity if needed.
- **Banks 4** – The council's own banker 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 Operations** – the council will use these where the parent bank has the necessary ratings outlined above.
- **Building Societies** – the council will use Societies which:

  i. meet the ratings for banks outlined above, or are both:

  ii. Eligible Institutions; and

  iii. Have assets in excess of £500 million.
- **Money Market Funds** – AAA
- **UK Government** (including gilts and the DMADF)
- **Local Authorities, Parish Councils etc**
- **Supranational institutions**

24. **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.

25. **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, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

26. **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 yrs
Lower Limit Category	F2/A-	P-2/A3	A-2/A-	£5m	1 yrs
Other Institution Limits	-			£5m	3 yrs
Guaranteed Organisations	-			£5m	various

(The Upper Limit category will include banks and building societies. The Lower 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 Strategic Director.

27. The proposed criteria for Specified and Non-Specified investments are shown in Annex A1 for approval.

28. 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.

29. 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.

30. **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.

31. There is an operational difficulty arising from the current banking crisis. There is currently little value investing longer term unless credit quality is reduced. Whilst some selective options do provide additional yield uncertainty over counterparty creditworthiness suggests shorter dated investments would provide better security.

32. **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 Strategic Director 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.

33. 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. The credit criteria have been amended to reflect these facilities.

Sensitivity to Interest Rate Movements

34. 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. [This table would also show the effect of interest rate changes on borrowing costs for authorities with debt.]

	2010/11 Estimated + 1%	2010/11 Estimated - 1%
Revenue Budget variance		
Investment income	+ £295,000	- £295,000

Treasury Management Prudential Indicators and Limits on Activity

35. There are four further 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. At this council, with no debt, these indicators apply only to investments. They are:

- Upper limits on variable interest rate exposure – With the level of operation at this council we have not felt the need to use period investments at variable interest rates. Currently an instant access bank deposit account is available for "overnight" investment. The interest rate is revised 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.
- 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 paid over to the Government or to precepting bodies.

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

£m	2010/11	2011/12	2012/13
Interest rate Exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates: • Debt only • Investments only	 nil £50 m	 nil £50 m	 nil £50 m
Limits on variable interest rates • Debt only • Investments only	 nil £10 m	 nil £10 m	 nil £10 m
Maturity structure of fixed interest rate borrowing 2010/11 – not applicable			
Maximum principal sums invested > 364 days			
Principal sums invested > 364 days	£20 m	£20 m	£20 m

Performance Indicators

37. 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:

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

The results of these indicators will be reported in the Treasury Annual Report.

Treasury Management Advisers

38. The council uses Butlers as its treasury management consultants, in a joint agreement with South. The company provides a range of services which include:

- Technical support on treasury matters, capital finance issues and the drafting of Member reports;
- Economic 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.

39. 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

40. 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 will offer training for Members and officers where required if suitable opportunities can be identified.

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

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.

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. 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.	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.	
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 company, and a maximum period of investment of 6 months	£3 million
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 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 and new counterparties which meet the criteria will be added to the list.

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 keep to the council's investment strategy. The council receives monthly activity reports. Butlers report on the performance of the manager quarterly and the annual performance is reported to Council in a report on the performance of cash investments after the year-end.

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 breached from time to time. Any breach will be reported, with supporting reasons, in the Annual Treasury Report.

Yield – The local benchmark currently used to assess investment performance for the in-house team and the fund manager is the level of returns above 7 day LIBID. (London Interbank BID rate. The interest rate a bank will pay to borrow from another bank.)

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.

As is the case with much of this report, the CLG and CIPFA guidance is aimed at a relatively large authority with borrowing and investments spread over a number of years. Worked examples from Butlers assume investments of £50 million over 5 years.

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). The in-house team keeps a daily cash-flow forecast and would only have an unseen requirement if say a large receipt was held up. In that case very short term borrowing would be considered. 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 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 – shorter WAL would generally embody less risk. In this respect the proposed benchmark is to be used:

- WAL benchmark is expected to be 21 days, with a maximum of 182 days.

Security of the investments – In the 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 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.

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 only rarely make an investment of 1 year and most are much shorter. Work still needs to be done to see if this methodology is suitable for mostly short-term investments.

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

- 0.02% historic risk of default when compared to the whole portfolio. (i.e. equivalent to £200 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 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.

Treasury Management Clauses to form part of Financial Regulations

1. This Council will create and maintain, as a basis for effective treasury management:

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

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 Executive, and for the execution and administration of treasury management decisions to the Strategic Director and Chief Finance officer, 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 and Governance Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.