
Report to Council

Date of Meeting: 28 June 2012

Subject: Treasury Management Strategy Statement 2012-2013

Report by: Accountancy Manager

1.0 Purpose

- 1.1. The purpose of this report is to present the Council's Treasury Management Strategy Statement for 2012/13.

2.0 Recommendations

- 2.1. It is recommended that Council
- 2.1.1. Approve the Treasury Management Strategy Statement and Annual Investment Strategy for 2012/13 attached as Appendix A.
 - 2.1.2. Adopts the revised Treasury Management Policy Statement attached as Appendix B
 - 2.1.3. Notes the requirements of the CIPFA Treasury Management Code of Practice Key Principles and Clauses outlined in Appendix C.

3.0 Considerations

Background

- 3.1. The need to prepare a Treasury Management Strategy Statement and a Treasury Management Policy Statement is a requirement of CIPFA's revised Treasury Management in the Public Services Code of Practice. In December 2010 the Council formally adopted the revised Code of Practice (2009 version). It should be noted that the Code has since been further updated in 2011, but there are only minor changes. This Treasury Management Strategy Statement has been prepared in accordance with the updated 2011 Code.
- 3.2. The Treasury Management Strategy Statement sets out the borrowing, investment and debt rescheduling strategies for the current year 2012/13. This builds on the existing strategy approved in December 2010, and takes into account prospects for interest rates, together with the treasury limits and proposed capital financing requirements outlined in the Prudential Indicators report approved at the Special Council meeting on 9th February 2012.

Treasury Management Strategy Statement and Annual Investment Strategy

- 3.3. The 2012/13 Treasury Management Strategy Statement and Annual Investment Strategy sets out the expected treasury management activities for the Council in the current financial year and is attached at Appendix A.

Treasury Management Policy Statement

- 3.4. The current Treasury Management Policy Statement was approved by Council on 19 December 2010. As mentioned in paragraph 3.1 an updated 2011 CIPFA Treasury Management Code of Practice has been produced. One of the changes required by the Code was to incorporate the Council's high level policies for borrowing and investments into the Treasury Management Policy Statement.
- 3.5. A copy of the revised Treasury Management Policy Statement is attached at Appendix B for adoption by the Council. The changes from the previous Statement is the insertion of the last two bullet points.
- 3.6. For completeness the key principles and specific clauses upon which the CIPFA Treasury Management Code of Practice is based upon, which were outlined in the December 2010 report to Council, are presented in Appendix C.

External Treasury Management Advisers

- 3.7 The Council uses Sector Treasury Services as its external treasury management advisors. Sector were appointed as advisor in September 2009 under formal tender arrangements and the contract is in place until July 2013 with the option of an extension for a further year beyond that date.

4.0 Conclusion

- 4.1 The Treasury Management Strategy for 2012/13 builds on and consolidates the Council's existing Investment Strategy and Prudential Borrowing framework.
- 4.2 The strategy supports the delivery of the Council's capital investment plans but also remains intent on reducing the Council's overall relative level of external debt compared to Scottish averages.

5.0 Sustainability Implications

- 5.1 There are no sustainability implications.

6.0 Resource Implications

- 6.1 *Financial Details*

6.2 There are no direct financial implications arising from the recommendations in this report. Yes ☒

6.3 Finance have been consulted and have agreed the financial implications as set out in the report. Yes ☒

6.4 *Staffing*

6.5 *None*

7.0 Exempt Reports

Is this report exempt? Yes ☐ (please detail the reasons for exemption below) No ☒

8.0 Declarations

The recommendations contained within this report support or implement our Corporate Priorities and Council Policies.

(1) **Our Priorities 2008 - 2011** (Please double click on the check box ☒)

The area has a positive image and attracts people and businesses	<input type="checkbox"/>
Our communities are more cohesive and inclusive	<input type="checkbox"/>
People are better skilled, trained and ready for learning and employment	<input type="checkbox"/>
Our communities are safer	<input type="checkbox"/>
Vulnerable people and families are supported	<input type="checkbox"/>
Substance misuse and its effects are reduced	<input type="checkbox"/>
Health is improving and health inequalities are reducing	<input type="checkbox"/>
The environment is protected and enhanced for all	<input type="checkbox"/>
The Council is effective, efficient and recognised for excellence	<input checked="" type="checkbox"/>

(2) **Council Policies** (Please detail)

9.0 Equalities Impact

9.1 Have you undertaken the required equalities impact assessment to ensure that no groups are adversely affected by the recommendations?
Yes ☐ No ☒

10.0 Legality

10.1 It has been confirmed that in adopting the recommendations contained in this report, the Council is acting within its legal powers. Yes ☒

11.0 Appendices

- 11.1 Please list any appendices attached to this report. If there are no appendices, please state "none".

Appendix A - Treasury Management Strategy Statement & Annual Investment Strategy

Appendix B - Treasury Management Policy Statement

Appendix C - CIPFA Treasury Management Code of Practice Key Principles and Clauses

Appendix D - Permitted Investments

12.0 Background Papers

- 12.1 Have you used other documents to compile your report? (All documents must be kept available by the author for public inspection for four years from the date of meeting at which the report is considered)

Yes ☒ (please list the documents below) No ☐


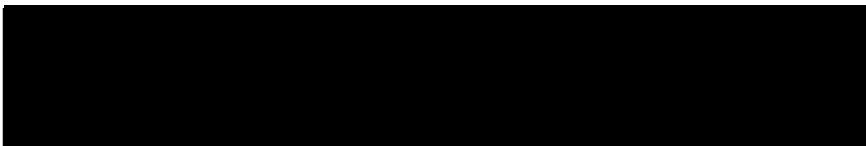
Treasury Management in Public Service; Code of Practice and Cross Sectoral Guidance Notes 2011

The Prudential Code for Capital Finance in Local Authorities 2011

Author(s)

NAME	DESIGNATION	TEL NO / EXTENSION
Craig Dickson	Team Leader - Accountancy	2037
Martin Dunsmore	Accountancy Manager	2041

Approved by

NAME	DESIGNATION	SIGNATURE
Nikki Bridle	Director of Finance and Corporate Services	
Elaine McPherson	Chief Executive	

2012/13 TREASURY MANAGEMENT STRATEGY STATEMENT & ANNUAL INVESTMENT STRATEGY

1. INTRODUCTION

1.1 Background

Treasury Management is defined as:

“The management of the local authority’s investments and cash flows, its banking, money market and capital market transactions; effective control of the risks associated with those activities; and the pursuit of optimum performance associated with those risks.”

1.2 Prudential and Treasury Indicators

Prudential and Treasury Indicators are relevant for the purposes of setting an integrated treasury management strategy. The Council has already approved these as part of the Council Tax budget setting process at the meeting of the 9th February 2012. The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The latest version of this Code is the November 2011 edition.

1.3 Balanced Budget Requirement

It is a statutory requirement under Section 93 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, a local authority must calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from:

1. increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
2. any increases in running costs from new capital projects

are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

These matters have already been given due consideration as part of the Council’s annual budget setting process and in particular within the specific report on the prudential indicators.

1.4 Treasury Management Strategy for 2012/13

The suggested strategy for 2012/13 in respect of the following aspects of the treasury management function is based upon the Council's views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser, Sector Treasury Services.

The proposed strategy for 2012/13 covers the following:

- the Council’s current portfolio position
- the treasury limits in force which will limit treasury risk and activities of the Council
- the prospects for interest rates

- the Council's borrowing requirement
- the borrowing strategy for 2012/13
- policy on borrowing in advance of need
- debt rescheduling opportunities
- the investment strategy for 2012/13

Current Portfolio Position

At any point in time the Council will have debt owed to external parties and investment monies held by approved counterparties and upon which the Council can make a financial return. The Council's treasury portfolio position at 31 March 2012 comprised of the following:

	Principal 31.3.2011		Principal 31.3.2012
Fixed Rate Borrowing:			
- Public Works Loan Board	£ 99.702m		£ 99.702m
- European Investment Bank	£ 0.110m		£ 0.057m
- Market	£ 14.000m	£113.812m	£ 14.000m £113.759m
Variable Rate Borrowing:			
- Market		£ 9.500m	£ 9.500m
Total External Debt		£123.312m	£123.259m
Investments:			
- Internally managed - Cash & Bank	£ 17.460m		£ 30.683m
- Long Term Investments	£1,426m		£1.426m
Total Investments		£18.886m	£31.109m
Total Net External Borrowing		£ 104.426m	£ 92.150m

There was no new long term borrowing undertaken during 2011/12, and neither did any long term borrowing mature for repayment during the year. The significant reduction in the net external borrowing position is due to the increase in cash balances held of over £13m.

Treasury Limits 2012/13 to 2014/15

It is a statutory duty under part 7 of the Local Government in Scotland Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to allocate to capital expenditure. The amount so determined is termed the "Affordable Capital Expenditure Limit".

The Council must have regard to the Prudential Code when setting the Affordable Capital Expenditure Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is 'acceptable'.

The affordable capital expenditure limit is set, on a rolling basis, for the forthcoming financial year and two successive financial years. The estimated Capital Expenditure for Clackmannanshire Council was outlined in the Prudential Indicators report to the February

Special Council at £17.207m, £14.024m and £14.405m for 2012/12, 2013/14 and 2014/15 respectively.

Interest Rate Prospects

Sector Treasury Services Ltd act as the Council's treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the Sector view on interest rate movements over the next few years.

Annual Average %	Bank Rate	Money Rates		PWLB Borrowing Rates		
		3 month	1 year	5 year	25 year	50 year
March 2012	0.50	0.70	1.50	2.30	4.20	4.30
June 2012	0.50	0.70	1.50	2.30	4.20	4.30
Sept 2012	0.50	0.70	1.50	2.30	4.30	4.40
Dec2012	0.50	0.70	1.60	2.40	4.30	4.40
March 2013	0.50	0.75	1.70	2.50	4.40	4.50
June 2013	0.50	0.80	1.80	2.60	4.50	4.60
Sept 2013	0.75	0.90	1.90	2.70	4.60	4.70
Dec 2013	1.00	1.20	2.20	2.80	4.70	4.80
March 2014	1.25	1.40	2.40	2.90	4.80	4.90
June 2014	1.50	1.60	2.60	3.10	4.90	5.00

Growth in the UK economy is expected to be weak in the next two years and there is a risk of a technical recession (i.e. two quarters of negative growth). Bank Rate, currently 0.5%, is not expected to start increasing until quarter 3 of 2013 despite inflation currently being well above the Monetary Policy Committee inflation target.

The outlook for borrowing rates is currently much more difficult to predict. The UK total national debt is forecast to continue rising until 2015/16. With fixed interest borrowing rates based on UK gilt yields it is expected there will be an increase in gilt yields over this period. However, gilt yields are currently at historically low levels due to investor concerns over Eurozone sovereign debt and have been subject to exceptionally high levels of volatility as events in the Eurozone debt crisis have evolved.

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

- The Eurozone sovereign debt difficulties, most evident in Greece, provide a clear indication of much higher counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2012/13;
- Borrowing interest rates are currently attractive, but may remain low for some time. The timing of any borrowing will need to be monitored carefully;
- There will remain a cost of capital – any borrowing undertaken that results in an increase in investments will incur a revenue loss between borrowing costs and investment returns.

Borrowing Requirement

The Council's borrowing requirement shown in the table below is based on the in year borrowing estimated to be needed to fund the net expenditure in the Financial Plans / Capital Budgets for both Housing and General Fund Services which were approved at the Special Council meeting in February 2012.

The actual timing of borrowing will be influenced by prevailing interest rates and expectations for future movement on rates. It may for instance be beneficial to delay borrowing until later than expected if interest rates are projected to fall. Similarly, any slippage in the delivery of the capital programme or conversely new initiatives requiring funding, will influence the timing of borrowing.

Replacement borrowing will be required for loan debt which is due to mature during the years shown. It has been assumed in the table below that this debt will be replaced in full in the year it matures, although this will be reviewed to take account of levels of cash balances held and interest rate movements so that borrowing is planned at the most opportune times. There also remains an intention in this strategy to reduce overall level of external debt compared to Scottish averages, and this will have a bearing on replacement borrowing decisions.

	2012/13 Estimate £000	2013/14 Estimate £000	2014/15 Estimate £000
Net New External Borrowing	2,540	1,160	634
Replacement Borrowing	4,000	4,000	10,000
Total Borrowing Requirement	6,540	5,160	10,634

It should be noted that replacement borrowing does not increase the level of the Council's total debt because by its nature this borrowing is replacing debt which already exists. The impact on the Council's external debt position is therefore only the net new borrowing requirement shown.

Borrowing Strategy

As indicated above the Council's total borrowing requirement for the period 2012/13 to 2014/15 is £22.334m and it is currently expected that the vast majority of this borrowing will be secured from the Public Works Loan Board. PWLB Loans are anticipated to be undertaken predominantly on a maturity basis with fixed interest rates. However should market borrowing become available the Director of Finance and Corporate Services will consider this option should it be beneficial to the Council.

The forecast new PWLB borrowing interest rates over the next three years are set out in the earlier table on interest rate prospects. It will be noted that PWLB interest rates are expected to increase marginally towards the latter part of this financial year, with steeper rises expected from 2013/14 onwards

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

Against this background the Director of Finance and Corporate Services will monitor the interest rate market and adopt a practical and prudent approach to changing circumstances. The following scenarios will influence the timing of any decision to alter the current strategy

of utilising internal borrowing (ie run down cash balances) rather than taking on new long term borrowing:

- if it was felt that there was a significant risk of a sharp FALL in long and short term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
- if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

Ultimately, the council's proposed strategy for borrowing for 2012/13 is to be as flexible as possible within the constraints of the Prudential Indicators set, so that borrowing is undertaken at what is considered to be the best time.

Policy on borrowing in advance of need

As a matter of policy the Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed as such action is illegal. In accordance with the revised Treasury Management Code, any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

Although the position will be kept under review and members will be advised of any intended change the proposed Treasury Management Strategy for 2012/13 assumes that no borrowing in advance of need (as defined in the Code on the Investment of Money By Scottish Local Authorities) will be required or take place. The maximum extent to which borrowing in advance will be undertaken in 2012/13 is therefore nil.

Debt Rescheduling

Clackmannanshire Council has over a number of years used changing market conditions to take advantage of debt rescheduling opportunities. Significant financial savings have been made through such action and opportunities to restructure the Council's debt portfolio will continue to be sought during 2012/13.

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

The reasons for any rescheduling will include one or more of the following:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the borrowing strategy outlined above;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

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

Any debt rescheduling undertaken will be reported as part of the Treasury Management mid year report or Treasury Management annual report..

Annual Investment Strategy

Investment Policy

Opportunities for investment arise naturally through Treasury Management activity and in particular the management of cash flows which can result in peaks and troughs in the amount of cash required during the year. The Council can also choose to have its various funds and reserves backed by cash held. Accordingly at any given point in time the Council is likely to have sizeable sums of cash available and in a best value context it is incumbent upon the Council to generate a return on such surplus cash by investing it wisely. It will noted that as at March 2012, these cash balances amounted to £30.7m. Income generated on the use of surplus cash contributes to keeping the net expenditure of the Council lower than it otherwise would be.

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

The Council will therefore aim to achieve the optimum return on its investments taking account of levels of security and liquidity. Striking an appropriate balance between risk and return is a matter of judgement for the Director of Finance and Corporate Services. However, the borrowing of monies purely to invest or on-lend and make a return is unlawful and thus the Council will not engage in such activity. The permitted investments that the Council can undertake are detailed in the scope of investment strategy that follows.

Investment Strategy

The scope of the Investment Strategy covers all investment undertaken by the Council, including but not limited to :-

- 1 Short and medium term liquid cash deposits with banks and buildings societies;
- 2 Investment in shares with companies, institutions and joint venture or related companies
- 3 Investment in non liquid fixed assets, for investment or resale

Under the 2010 Regulations, the Council is required to set out the types of investment that they will permit in the financial year, together with the limits for those investment. These are known as permitted investments.

The main permitted investments that the Council anticipates investing in will be immediate or short term deposit accounts with approved Banks or Buildings Societies. The Council currently receives favourable rates with one approved lender on instant access and fixed term deposits. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 3 of 2013. Bank Rate forecasts for financial year ends (March) are:

- 2012 0.50%
- 2013 0.50%
- 2014 1.25%
- 2015 2.50%

Allowing for the favourable investment returns the Council currently has in place, the suggested returns on investments than can be forecast for the next three years are as follows:

➤ 2012/13	2.20%
➤ 2013/14	2.80%
➤ 2014/15	4.50%

The full list of products and institutions that the Council is permitted to invest is included in Appendix D.

Creditworthiness policy

This Council utilises the creditworthiness service provided by Sector Treasury Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies.

This approach also combines a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

All credit ratings will be monitored on a weekly basis. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service, and appropriate action will be taken where downgrades in ratings result in the counterparty no longer meeting the Council's minimum criteria.

As an added measure, sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on government support for banks and the credit ratings of those banks eligible for government support.

Country limits

The Council has determined that it will only use approved counterparties registered to take deposits in the United Kingdom.

End of Year Investment Report

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

Treasury Management Policy Statement

The need to prepare a Treasury Management Policy Statement is a requirement of the Treasury Management in the Public Services Code of Practice published by the Chartered Institute of Public Finance and Accountancy in 2011.

The Treasury Management Policy Statement for Clackmannanshire Council is as follows:

- 1 The Council defines its treasury management activities as the management of its investments and cash flows, its banking, money market and capital market transactions: the effective control of the risks associated with those activities: and the pursuit of optimum performance consistent with those risks.
- 2 The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its investment and treasury management activities will be measured. Accordingly, the analysis and reporting of investment and treasury management activities will focus on their risk implications for the Council.
- 3 The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.
- 4 The Council's policy regarding borrowing is to borrow as required to meet our capital financing requirement all in accordance with the Council's Annual Treasury Management Strategy. The Council will also not borrow for the purpose of re-investing.
- 5 The Council's policy regarding investments is to invest surplus funds with reference to the Council's core cash balances and cashflow requirements all in accordance with the Council's Annual Investment Strategy.

CIPFA Treasury Management Code of Practice Key Principles and Clauses

Key Principles

The CIPFA Treasury Management in the Public Services Code of Practice (revised 2011) identifies the following 3 Key Principles in respect of Treasury Management in the public services:

- 1 Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.
- 2 Their policies and practices should make clear that the effective management and control of risk are prime objectives of their treasury management activities and that responsibility for these lies clearly with their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and liquidity when investing funds.
- 3 They should acknowledge that the pursuit of value for money in treasury management, and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this.

Approved Clauses

CIPFA recommends that all public service organisations adopt, as part of their standing orders, financial regulations, or other formal policy documents appropriate to their circumstances the following four clauses.

- 1 The Council will create and maintain, as the cornerstones 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 Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendments where necessary to reflect the particular circumstances of the Council. Such amendments will not result in the Council materially deviating from the Code's key principles.

- 2 The full 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 regular monitoring of its treasury management policies and practices to the Scrutiny Committee, and for the execution and administration of treasury management decisions to the Director of Finance and Corporate Services who will act in accordance with the organisation's policy statement and TMPs and as a CIPFA member CIPFA's Standard of Professional Practice on Treasury Management.
- 4 The Council nominates the Scrutiny Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

Appendix D

PERMITTED INVESTMENTS

This Council approves the following forms of investment instrument for use as permitted investments as set out in Tables 1 to 6 below:

Table 1 - Deposits

	Minimum Credit Criteria	Liquidity Risk	Market Risk	Max % of total investments	Max Maturity period
Debt Management Agency Deposit facility	Not applicable	Term	No	Unlimited	2 years
Term deposits - local authorities	Not Applicable	Term	No	Unlimited	2 years
Call accounts - banks and building societies	Long Term Rating A+	Instant	No	Unlimited	2 years
Term deposits - banks and building societies	Long Term Rating A+	Term	No	Unlimited	2 years
Fixed term deposits with variable rate: Structured deposits	Long Term Rating A+	Term	No	40	2 years
Collateralised deposit	UK Sovereign Rating	Term	No	40	2 years

Table 2 - Deposits with counterparties in receipt of government support/owner

	Minimum Credit Criteria	Liquidity Risk	Market Risk	Max % Of total Investments	Max maturity period
UK nationalised banks	Long Term Rating A+	Term	No	Unlimited	2 years
UK Government support to the banking sector (implicit guarantee)	Long Term Rating A+	Term	No	Unlimited	2 years
Fixed term deposits with variable rates and variable maturities: Structured deposits	Long Term Rating A+	Term	No	40	2 years
Call accounts - banks and building societies	Long Term Rating A+	Instant	No	Unlimited	2 years

Table 3 - Collective Investment schemes structured as Open Ended Investment Companies (OEICs)

	Minimum Credit Criteria	Liquidity Risk	Market Risk	Max % Of total Investments	Max Maturity period
Government Liquidity Funds	UK Sovereign Rating	Instant	No	5	2 years
Money Market Funds	UK 1Sovereign Rating	Instant	No	Unlimited	2 years
Enhanced Cash Funds	UK Sovereign Rating	T+>1	Yes	5	2 years
Gilt Funds	UK Sovereign rating	T+>1	Yes	5	2 years
Bond Funds	UK Sovereign Rating	T+>1	Yes	5	2 years

Table 4 - Securities issued or guaranteed by governments

	Minimum Credit Criteria	Liquidity Risk	Market Risk	Max % Of total Investments	Max Maturity period
Treasury Bills	UK Sovereign Rating	Sale T+1	Yes	5	2 years
UK Government Gilts	UK Sovereign Rating	Sale T+1	Yes	5	2 years
Bonds issued by a financial institution which is explicitly guaranteed by the UK Government	UK Sovereign Rating	Sale T+3	Yes	5	2 years

Table 5 - Securities issued by corporate organisations

	Minimum Credit Criteria	Liquidity Risk	Market Risk	Max % Of total Investments	Max Maturity period
Certificates of deposit issued by banks and building societies	Long Term Rating A+	Sale T+1	Yes	5	2 years
Commercial paper	Long Term Rating A+	Sale T+1	Yes	5	2 years
Corporate Bonds	Long Term Rating A+	Sale T+3	Yes	5	2 years
Other debt issuance by UK banks covered by UK Government (explicit) guarantee	Long Term Rating A+	Sale T+3	Yes	5	2 years

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

Table 6 - Non Treasury Investments

	Minimum Credit Criteria	Liquidity Risk	Market Risk	Max % Of total Investments	Max Maturity period
Property Fund	Not Applicable	Not Applicable	Yes	5	2 years
Local authority mortgage guarantee scheme	Not applicable	Not Applicable	No	5	2 years
Investment Properties	Not Applicable	Not Applicable	Yes	Unlimited	Unlimited
Home Loans	Not Applicable	Not Applicable	No	Unlimited	Unlimited

Treasury risks

All the investment instruments in Tables 1 to 6 above are subject to the following risks: -

1. **Credit and counter-party risk:** this is the risk of failure by a counterparty (bank or building society) to meet its contractual obligations to the organisation particularly as a result of the counterparty's diminished creditworthiness, and the resulting detrimental effect on the organisation's capital or current (revenue) resources. There are no counterparties where this risk is zero although AAA rated organisations have a very high level of creditworthiness.

2. **Liquidity risk:** this is the risk that cash will not be available when it is needed. While it could be said that all counterparties are subject to at least a very small level of liquidity risk as credit risk can never be zero, in this document, liquidity risk has been treated as whether or not instant access to cash can be obtained from each form of investment instrument. However, it has to be pointed out that while some forms of investment e.g. gilts, CDs, corporate bonds can usually be sold immediately if the need arises, there are two caveats:
 - a. cash may not be available until a settlement date up to three days after the sale
 - b. there is an implied assumption that markets will not freeze up and so the instrument in question will find a ready buyer.
3. **Market risk:** this is the risk that, through adverse market fluctuations in the value of the principal sums an organisation borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately.
4. **Interest rate risk:** this is the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately.
5. **Legal and regulatory risk:** this is the risk that the organisation itself, or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, and that the organisation suffers losses accordingly.

Controls on treasury risks

1. **Credit and counter-party risk:** the Council has set minimum credit criteria to determine which counterparties and countries are of high creditworthiness to enable investments to be made safely.
2. **Liquidity risk:** the Council has a cash flow forecasting model to enable it to determine how long investments can be made for and how much can be invested.
3. **Market risk:** the Council does not purchase investment instruments which are subject to market risk in terms of fluctuation in their value.
4. **Interest rate risk:** the Council manages this risk by having a view of the future course of interest rates and then formulating a treasury management strategy accordingly which aims to maximise investment earnings consistent with control of risk or alternatively, seeks to minimise expenditure on interest costs on borrowing.
5. **Legal and regulatory risk:** the Council will not undertake any form of investing until it has ensured that it has all necessary powers and also complied with all regulations.

Unlimited investments

Paragraph 24 of the Investment Regulations states that an investment can be shown in an authorities permitted investments as being 'unlimited' in terms of the maximum amount or percentage of the total portfolio that can be put into that type of investment. However, it also requires that an explanation must be given for using that category

.

The Council has given the following types of investment an unlimited category: -

1. **Debt Management Agency Deposit Facility.** This is considered to be the lowest risk form of investment available to local authorities as it is operated by the Debt Management Office which is part of H.M. Treasury i.e. the UK Government's AAA rating stands behind the DMADF. It is also a deposit account and avoids the complications of buying and holding Government issued treasury bills or gilts.
2. **High credit worthiness banks and building societies.** The Annual Investment Strategy section provides an explanation of this Council's definition of high credit worthiness. While an unlimited amount of the investment portfolio may be put into banks and building societies with high credit worthiness, the Council will ensure diversification of its portfolio by limiting the value of investment that can be placed with one institution or group.
3. **Deposits with UK Local Authorities.** It is considered that there is negligible counterparty risk with such lending (local authorities effectively having the same credit rating as the Government itself). On this basis such lending should have no limits placed upon it.
4. **Money Market Funds.** These investments are considered relatively low risk as they are normally AAA rated (the highest credit rating available), offer instant access to funds and are a widely diversified form of investment.

DEPOSITS

The following forms of 'investments' are actually more accurately called deposits as cash is deposited in an account until an agreed maturity date or is held at call.

- a) **Debt Management Agency Deposit Facility.** This offers the lowest risk form of investment available to local authorities as it is effectively an investment placed with the Government. It is also easy to use as it is a deposit account and avoids the complications of buying and holding Government issued treasury bills or gilts. As it is low risk it also earns low rates of interest. However, it is very useful for authorities whose overriding priority is the avoidance of risk at a time when many authorities are disappointed at the failure in 2008 of credit ratings to protect investors from the Icelandic bank failures and are both cautious about other forms of investing and are prepared to bear the loss of income to the treasury management budget compared to earnings levels in previous years. The longest term deposit that can be made with the DMADF is 6 months.

- b) **Term deposits with high credit worthiness banks and building societies.** This is the most widely used form of investing used by local authorities. It offers a much higher rate of return than the DMADF (dependent on term) and now that measures have been put in place to avoid over reliance on credit ratings, the Council feels much more confident that the residual risks around using such banks and building societies are at a low, reasonable and acceptable level. The will ensure diversification of its portfolio of deposits. In addition, longer term deposits offer an opportunity to increase investment returns by locking in high rates ahead of an expected fall in the level of interest rates. At other times, longer term rates can offer good value when the markets incorrectly assess the speed and timing of interest rate increases. This form of investing therefore, offers a lot of flexibility and higher earnings than the DMADF. Where it is restricted is that once a longer term investment is made, that cash is locked in until the maturity date.
- c) **Call accounts with high credit worthiness banks and building societies.** The objectives are as for term deposits. but there is instant access to recalling cash deposited. This generally means accepting a lower rate of interest than that which could be earned from the same institution by making a term deposit. However, there are a number of call accounts which at the time of writing, offer rates 2 – 3 times more than term deposits with the DMADF. Some use of call accounts is highly desirable to ensure that the Council has ready access to cash when needed.
- d) **Fixed term deposits with variable rate and variable maturities (structured deposits).** This line encompasses ALL types of structured deposits. There has been considerable change in the types of structured deposits brought to the market over the last few years, some of which are already no longer available. In view of the fluidity of this area, this is a generic title for all structured deposits so as to provide councils with greater flexibility to adopt new instruments as and when they are brought to the market.
- e) **Collateralised deposits.** These are deposits placed with a bank which offers collateral backing based on LOBOs borrowed by local authorities. Such deposits are effectively lending to a local authority as that is the ultimate security.

DEPOSITS WITH COUNTERPARTIES CURRENTLY IN RECEIPT OF GOVERNMENT SUPPORT / OWNERSHIP

These banks offer another dimension of creditworthiness in terms of Government backing through either direct (partial or full) ownership or the banking support package. The view of this Council is that such backing makes these banks attractive institutions with whom to place deposits, and that will remain our view if the UK sovereign rating were to be downgraded in the coming year.

- a. **Term deposits with high credit worthiness banks which are fully or semi nationalised.** As for **b** in previous section. but Government ownership partial or full implies that the Government stands behind this bank and will be deeply committed to providing whatever support that may be required to ensure the continuity of that bank. This Council considers this indicates a low and acceptable level of residual risk.
- b. **Term deposits with high credit worthiness banks and building societies which are specified as being eligible for support by the UK Government.** As for **a**(above) but Government stated support implies that the Government stands behind eligible banks and building societies and will be deeply committed to providing whatever support that may be required to ensure the continuity of such institutions. This Council feels this indicates a low and acceptable level of residual risk.

- c. **Fixed term deposits with variable rate and variable maturities (structured deposits).** This line encompasses ALL types of structured deposits. There has been considerable change in the types of structured deposits brought to the market over the last few years, some of which are already no longer available. In view of the fluidity of this area, this is a generic title for all structured deposits so as to provide councils with greater flexibility to adopt new instruments as and when they are brought to the market. However, this does mean that members ought to be informed as to what instruments are presently covered under this generic title so that they are aware of the current situation, and that they are informed and approve of intended changes in an appropriate manner.

COLLECTIVE INVESTMENT SCHEMES STRUCTURED AS OPEN ENDED INVESTMENT COMPANIES (OEICS)

- a. **Government liquidity funds.** These are very similar to money market funds (see below) but only invest in government debt issuance with highly rated governments. They offer a lower rate of return than MMFs but slightly higher than the returns from the DMADF.
- b. **Money Market Funds (MMFs).** MMFs are normally AAA rated and are widely diversified, using many forms of money market securities including types which this Council does not currently have the expertise or risk appetite to hold directly. However, due to the high level of expertise of the fund managers and the huge amounts of money invested in MMFs, and the fact that the weighted average maturity (WAM) cannot exceed 60 days, MMFs offer a combination of high security, instant access to funds, high diversification and good rates of return compared to equivalent instant access facilities.
- c. **Enhanced cash funds.** These funds are similar to MMFs, can still be AAA rated but have variable Net Asset Values (NAV) as opposed to a traditional MMF which has a stable NAV. They aim to achieve a higher yield and to do this either take more credit risk or invest out for longer periods of time, which means they are more volatile. These funds can have WAM's and Weighted Average Life (WAL's) of 90 – 365 days or even longer. Their primary objective is yield and capital preservation is second. They therefore are a higher risk than MMFs and correspondingly have the potential to earn higher returns than MMFs.
- d. **Gilt funds.** These are funds which invest only in U.K. Government gilts. They offer a lower rate of return than bond funds but are highly rated both as a fund and through investing only in AAA rated gilts. They offer a higher rate of return than investing in the DMADF but they do have an exposure to movements in market prices of assets held.
- e. **Bond funds.** These invest in both government and corporate bonds. This therefore entails a higher level of risk exposure than gilt funds and the aim is to achieve a higher rate of return than normally available from gilt funds by trading in bonds. They do have an exposure to movements in market prices of assets held so do not offer constant Net Asset Value.

SECURITIES ISSUED OR GUARANTEED BY GOVERNMENTS

The following types of investments are where an authority directly purchases a particular investment instrument, a security, i.e. it has a market price when purchased and that value can change during the period the instrument is held until it matures or is sold. The annual earnings on a security is called a yield i.e. it is normally the interest paid by the issuer divided by the price you paid to purchase the security unless a security is initially issued at a discount e.g. treasury bills..

- a. **Treasury bills.** These are short term bills (up to 12 months) issued by the Government and so are backed by the sovereign rating of the UK. The yield is higher than the rate of interest paid by the DMADF and another advantage compared to a time deposit in the DMADF is that they can be sold if there is a need for access to cash at any point in time. However, there is a spread between purchase and sale prices so early sales could incur a net cost during the period of ownership.
- b. **Gilts.** These are longer term debt issuance by the UK Government and are backed by the sovereign rating of the UK. The yield is higher than the rate of interest paid by the DMADF and another advantage compared to a time deposit in the DMADF is that they can be sold if there is a need for access to cash at any point in time. However, there is a spread between purchase and sale prices so early sales may incur a net cost. The advantage over Treasury bills is that they generally offer higher yields the longer it is to maturity (for most periods) if the yield curve is positive.
- c. **Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government** (refers solely to GEFCO - Guaranteed Export Finance Corporation). This is similar to a gilt due to the explicit Government guarantee.
- d. **Sovereign bond issues (other than the UK govt) denominated in Sterling.** As for gilts but issued by other nations. AAA rated issues are just as secure as UK Government gilts but the advantage of these securities is they offer a slightly higher yield.
- e. **Bonds issued by Multi Lateral Development Banks (MLDBs).** These are similar to b. and d. above but are issued by MLDBs which are guaranteed by sovereign states with a high sovereign rating e.g. European Investment Bank. The advantages of these securities is they are more secure than UK Government gilts, as they are guaranteed by more than one AAA rated government, and offer a slightly higher yield.

SECURITIES ISSUED BY CORPORATE ORGANISATIONS

The following types of investments are where an authority directly purchases a particular investment instrument, a security, i.e. it has a market price when purchased and that value can change during the period the instrument is held until it is sold. The annual earnings on a security is called a yield i.e. is the interest paid by the issuer divided by the price you paid to purchase the security. These are similar to the previous category but corporate organisations can have a wide variety of credit worthiness so it is essential for local authorities to only select the organisations with the highest levels of credit worthiness. Corporate securities are generally a higher risk than government debt issuance and so earn higher yields.

- a. **Certificates of deposit (CDs).** These are shorter term securities issued by deposit taking institutions (mainly banks) so they can be sold if there is a need for access to cash at any point in time. However, that liquidity comes at a price so the yield is less than placing a deposit with the same bank as the issuing bank.
- b. **Commercial paper.** This is similar to CDs but is issued by commercial organisations or other entities. Maturity periods are up to 365 days but commonly 90 days.
- c. **Corporate bonds.** These are (long term) bonds (usually bearing a fixed rate of interest) issued by a company or other non-government issuer in order to raise capital for the institution as an alternative to issuing shares or borrowing from banks. They are

generally seen to be of a lower creditworthiness than government issued debt and so usually offer higher rates of yield.

- d. **Floating rate notes.** These are bonds on which the rate of interest is established periodically with reference to short-term interest rates.

OTHER

- a. **Property fund.** This is a collective investment fund specialising in property. Rather than owning a single property with all the risk exposure that means to one property in one location rising or falling in value, maintenance costs, tenants actually paying their rent / lease etc, a collective fund offers the advantage of diversified investment over a wide portfolio of different properties. This can be attractive for authorities who want exposure to the potential for the property sector to rise in value. However, timing is critical to entering or leaving this sector at the optimum times of the property cycle of rising and falling values unless a long term commitment is made to retain exposure to the property market.
- b. **Local Authority Mortgage Guarantee Scheme.** Authorities who are participating in the Local Authority Mortgage Guarantee Scheme (LAMGS) may be required to place a deposit with the mortgage provider(s) up to the full value of the guarantee. The deposit will be in place for the term of the guarantee i.e. 5 years (with the possibility of a further 2 year extension if the account is 90+ days in arrears at the end of the initial 5 years) - and may have conditions / structures attached. The mortgage provider will not hold a legal charge over the deposit.

