REPORT TO: **POLICY AND RESOURCES COMMITTEE – 22 APRIL 2013**

REPORT ON: **TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2013/2014**

REPORT BY: **DIRECTOR OF CORPORATE SERVICES**

REPORT NO: **180-2013**

1 PURPOSE OF REPORT

This report introduces the Dundee City Council Treasury Management Strategy Statement and Annual Investment Strategy for 2013/2014, the preparation of which is a requirement of the Council's Treasury Policy Statement and the CIPFA Treasury Management in the Public Services Code of Practice.

2 RECOMMENDATION

The Committee are asked to:

1 note that in terms of the Treasury Policy Statement, the Director of Corporate Services is obliged to present the annual Treasury Management Strategy at the start of each financial year.

2 approve the strategy proposed by the Director of Corporate Services for 2013/2014 as set out in the attached document "Treasury Management Strategy 2013/2014".

3 FINANCIAL IMPLICATIONS

There are no direct financial implications arising from the recommendations in this report. However, decisions made within the Treasury Management function will affect the cost of the Council's long and short-term borrowing in 2013/2014 and future years. The 2013/2014 Revenue Budget has been set including a provision of £25.037m for Capital Financing Costs and this is based on an average Loans Fund Interest rate of 4.5%

4 BACKGROUND

The Council's Treasury Policy Statement Report No 183-2013 requires that the Policy and Resources Committee will receive and consider the Treasury Management Strategy at the start of each new financial year.

5 TREASURY MANAGEMENT STRATEGY 2013/2014

The Council's Treasury Management Strategy for 2013/2014 is set out in detail in the attached document. The net new borrowing required in 2013/2014 is £30m. In light of this there is expected to be phased borrowing during the year. This will be based on cash flow and interest rate monitoring to determine the term and value of each loan taken.

In light of the continuing uncertainties in the finance market, lending transactions will be closely monitored to achieve maximum security of capital. This will involve using all available sources of information to assess the financial strength of any counterparties.

6 POLICY IMPLICATIONS

This Report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality Impact Assessment and Risk Management.

The major issue is with Risk Management. This is considered in Appendix C of the statement.

7 CONSULTATION

The Chief Executive and the Head of Democratic and Legal Services have been consulted.

8 BACKGROUND PAPERS

None

MARJORY M STEWART
DIRECTOR OF CORPORATE SERVICES **15 APRIL 2013**

DUNDEE CITY COUNCIL

TREASURY MANAGEMENT STRATEGY 2013/2014

Corporate Services Department

TREASURY MANAGEMENT STRATEGY 2013/2014

1 INTRODUCTION

The Local Government in Scotland Act 2003 and supporting regulations require the Council to 'have regard to' the 'Prudential Code for Capital Finance in Local Authorities' published by the Chartered Institute of Public Finance and Accountancy (CIPFA) in 2011 and therefore to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. They also require the Council to have regard to the 'Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes' published by CIPFA in 2011 which require the Council to set out its treasury management strategy for borrowing and investment and how it will give priority to security and liquidity in managing its investments.

The suggested strategy for 2013/2014 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser, Sector Treasury Services.

The strategy covers:

- treasury limits in force which will limit the treasury risk and activities of the Council
- prudential and treasury indicators
- the current treasury position
- the borrowing requirement
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy
- creditworthiness policy
- policy on use of external service providers

<u>Balanced Budget Requirement</u>
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.

<u>Treasury Limits for 2013/2014 to 2015/2016</u>
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 Council must have regard to the Prudential Code when setting its capital expenditure plans, 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 affordable.

The capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The borrowing limits are to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

2 CURRENT TREASURY PORTFOLIO POSITION

The Council's loan debt position at 31 March 2013 was as follows:

		£m	£m	%
Fixed Rate Funding	Public Works Loan Board	361.4		
	Market Loans	20.0	381.4	90.3
Variable Rate Funding	Market Loans	20.0		
	Temporary Loans	20.8	40.8	9.7
Total Loan Debt			422.2	100.0
Investments				
Short Term Lending			5.7	

3 PRUDENTIAL AND TREASURY INDICATORS 2013/2014 - 2015/2016

Prudential and Treasury Indicators (Appendix A to this report) are relevant for the purposes of setting an integrated treasury management strategy.

The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This original 2001 Code was adopted by the Finance Committee and the revised Code was adopted on 26 March 2012 by the Policy and Resources Committee.

4 PROSPECTS FOR INTEREST RATES

The Council has appointed Sector Treasury Services as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates. Appendix B draws together a number of current forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Sector central view.

Sector Bank Rate forecast for financial year ends (March)

- 2013/2014 0.50%
- 2014/2015 0.75%
- 2015/2016 1.75%

There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected.

The effect on interest rates for the longer term is expected to be:

Longer term interest rates 50 years - PWLB rates are expected to be around 4% during the year.

5 BORROWINGS STRATEGY

The net borrowing requirement for capital expenditure is shown in Appendix A. In 2013/2014 it is £30m. Cash flows and PWLB rates will be monitored to determine the appropriate time to borrow and term of the loans to be taken. Estimates of the likely rates for different terms are shown at Appendix B. Short-term rates are expected to be lower but this must be balanced against the risk of having to re-finance at an earlier date.

Comparison of gross and net debt positions at year end	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**2015/16**
	Actual	**Probable Outturn**	**Estimate**	**Estimate**	**Estimate**
	£'000	£'000	£'000	£'000	£'000
Actual external debt (gross)	386	422	464	475	496
Cash Balances	7	6	5	5	5
Net Debt	379	416	459	470	491

- This Council currently has a difference between gross debt and net debt of £5m.
- The general aim of this treasury management strategy is to maintain the difference between the two debt levels over the next three years in order to reduce the credit risk incurred by holding investments. However, measures taken in the last year have already reduced substantially the level of credit risk so another factor which will be carefully considered is the difference between borrowing rates and investment rates to ensure the Council obtains value for money once an appropriate level of risk management has been attained to ensure the security of its investments.

Against this background caution will be adopted with the 2013/14 treasury operations. The Director of Corporate Services will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to the Policy and Resources Committee.

6 POLICY ON BORROWING IN ADVANCE OF NEED

The Council will not borrow in excess of its Capital Financing Requirement with the prime intention to profit from the investment of the extra sums borrowed. In accordance with the revised 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.

It is not expected that there will be any such borrowing over the next year.

7 DEBT RESCHEDULING

The introduction of different PWLB rates on 1 November 2007 for new borrowing as opposed to early repayment of debt and the setting of a spread between the two rates has meant that PWLB to PWLB restructuring is now much less attractive.

Opportunities will continue to be monitored and possible reasons would be:

- cash savings
- enhance balance of the long term profile with respect to maturity and volatility
- help fulfil portfolio strategy

8 ANNUAL INVESTMENT STRATEGY

Investment Policy

The Council will have regard to the Local Government Investment (Scotland) Regulations 2010 and accompanying finance circular, the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code") and the Audit Commission's report on Icelandic investments. The Council's investment priorities are: -

(a) the security of capital and
(b) the liquidity of its investments.

The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investments.

The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

Permitted investment instruments identified for use in the financial year are listed in Appendix C. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

Creditworthiness policy

This Council uses the creditworthiness service provided by Sector Treasury Services. This service has been progressively enhanced over recent years and now uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element. However, it does not rely solely on the current credit ratings of counterparties and may also use the following as overlays: -

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

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which can then be combined with an overlay of CDS spreads for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration of investments and are therefore referred to as durational bands. The Council is satisfied that this service gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.

The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Sector's weekly credit list of worldwide potential counterparties. The Council will therefore use counterparties within the following durational bands:-

- Purple 1 year
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No Colour not to be used

This Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties. The Sector creditworthiness service use ratings from all three agencies, but by using a scoring system, it does not give undue preponderance to just one agency's ratings.

All credit ratings will be monitored weekly. The Council is alerted daily to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

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

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

The maximum deposit will be in line with counterparty credit rating as follows
- F1+ £12m
- F1 £8m.
- UK Local Authorities £8m
- Debt Management Agency £12m

Please note additional frictional cash balances may be held in the Council's current account (currently with the Royal Bank of Scotland).

Country limits

The Council will only use UK regulated institutions.

Investment strategy

In-house funds*:* The Council's in-house managed funds are mainly cash-flow derived and thus only available for limited periods. Investments will accordingly be made with reference to the cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Interest rate outlook: Bank Rate has been unchanged at 0.50% since March 2009. Bank Rate is forecast to commence rising in 2014 and then to rise steadily from thereon. Bank Rate forecasts for financial year ends (March) are as follows: -

- 2013/2014 0.50%
- 2014/2015 0.75%
- 2015/2016 1.75%

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

For 2013/14 it is suggested that the Council should budget for an investment return of 0.50% on investments placed during the financial year.

For its cash flow generated balances, the Council will seek to utilise its business reserve and call accounts which are currently paying higher than market rates.

Policy on longer term investments

Until the new investment regulations took effect from 1 April 2010, investing by Scottish local authorities was limited to one year. This restriction has been removed from that date and this authority accordingly wishes to be able to make use of this power at times when such investing is both appropriate and attractive.

It is not expected this will be exercised in 2013/14 for general treasury management purposes.

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 Management Activity report.

Policy on the use of external service providers

The Council uses Sector Treasury Services as its external treasury management advisers.

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

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

Scheme of delegation

Policy and Resources Committee

- receiving and reviewing reports on treasury management policies, practices and activities.
- approval of annual strategy.
- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices.
- budget consideration and approval.

Director of Corporate Services

- Appendix D shows the responsibilities of the Director of Corporate Services per S.10 of the Council's Financial Regulations.
- approving the division of responsibilities within the Financial Services & Investment Section.
- approving the selection of external service providers and agreeing terms of appointment.
- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance.
- submitting regular treasury management policy reports.
- submitting budgets and budget variations.
- receiving and reviewing management information reports.
- reviewing the performance of the treasury management function.
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function.
- ensuring the adequacy of internal audit, and liaising with external audit.
- recommending the appointment of external service providers.

Internal Audit

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

Policy on scrutiny, monitoring and change of investment policies and practices

The Internal Audit Section will review the Treasury Management Practices (TMP's) of the authority. These set out all the policies and procedures in place to implement the treasury management strategy and the principles set out in the treasury management policy statement. They are intended to minimise the risk to the capital sum of investments and for optimising the return on the funds consistent with those risks. These TMP's have been adopted as part of the approval of the Treasury Policy Statement.

Any changes in the TMP's will be sent to Internal Audit for approval prior to implementation and any material change will be reported to the Policy and Resources Committee.

The Treasury Policy Statement will be reviewed at least every 3 years.

A copy of the TMP's may be obtained from the Head of Corporate Finance.

Permitted Investments – non treasury investments

Definition of non treasury investments

Regulation 9 adds to the normal definition of investments the following categories: -

a All share holding, unit holding and bond holding, including those in a local authority owned company, is an investment.

b Loans to a local authority company or other entity formed by a local authority to deliver services, are an investment.

c Loans made to third parties are investments.

d Investment property is an investment.

Any loan issued to a third party is treated as an investment. Such loans are neither capital nor revenue transactions, but are often made for service reasons and for which specific statutory provision exists. These loans will normally be made at prevailing market rates but may on occasion for service reasons be offered at an interest rate below the market rate. All loans to third parties are classified as investments for the purposes of the Consent. Where the loan is advanced at less than a market interest rate there is an associated loss of investment return which would otherwise have been earned on these monies. Annual Strategies and Reports will need to recognise all loans to third parties as investments.

Investment balances forecasts

Regulation 31 requires this authority to provide forecasts for the level of investments for the next three years, in line with the time frame of our capital investment programme.

The table in Appendix E shows that treasury investment balances have fallen over 2012/2013.

APPENDIX A

DUNDEE CITY COUNCIL
PRUDENTIAL CODE INDICATORS - TREASURY MANAGEMENT INDICATORS

Adoption of Revised CIPFA Treasury Management Code of Practice 2011	YES

Upper limit for variable rate exposure

		%
Net principal re variable rate borrowing/investments	2011/12	30
	2012/13	30
	2013/14	30
	2014/15	30
	2015/16	30
	2016/17	30
Net principal re fixed rate borrowing/investments	2011/12	100
	2012/13	100
	2013/14	100
	2014/15	100
	2015/16	100
	2016/17	100

Actual external debt (£000)	2011/12	£385,709

Maturity structure of fixed rate borrowing 2011/12

Where the periods are

	Lower %	Upper %
Under 12 months	0	10
12 months & within 24 months	0	15
24 months & within 5 years	0	25
5 years & within 10 years	0	25
10 years +	50	95

Upper limit for total principal sums invested for over 364 days	N/A	No sums will be invested longer than 364 days

Authorised limit for external debt with limit for borrowing and other long term liabilities identified	Borrowing £000	Other £000	Total £000
2011/12	413,000	83,000	496,000
2012/13	459,000	81,000	540,000
2013/14	489,000	79,000	568,000
2014/15	500,000	77,000	577,000
2015/16	521,000	75,000	596,000
2016/17	530,000	73,000	603,000

Operational boundary for external debt with limit for borrowing and other long term liabilities separately identified	Borrowing £000	Other £000	Total £000
2011/12	389,233	82,711	471,944
2012/13	434,000	81,000	515,000
2013/14	464,000	79,000	543,000
2014/15	475,000	77,000	552,000
2015/16	496,000	75,000	571,000
2016/17	505,000	73,000	578,000

PRUDENTIAL CODE INDICATORS - PRUDENTIAL INDICATORS

Capital expenditure

	Non-HRA £000	HRA £000	Total £000
2011/12	61,714	22,871	84,585
2012/13	71,549	21,030	92,579
2013/14	70,945	17,727	88,672
2014/15	79,114	15,106	94,220
2015/16	87,819	14,609	102,428
2016/17	45,828	16,742	62,570

Ratio of financing costs to net revenue stream

	Non-HRA %	HRA %
2011/12	6.7	38.4
2012/13	6.8	42.0
2013/14	7.5	44.7
2014/15	7.6	43.8
2015/16	7.6	43.3
2016/17	7.5	41.3

Net borrowing requirement

	b/f 1 April £000	c/f 31 March £000	In Year £000
2011/12	348,886	382,583	33,697
2012/13	382,583	434,000	51,417
2013/14	434,000	464,000	30,000
2014/15	464,000	475,000	11,000
2015/16	475,000	496,000	21,000
2016/17	496,000	505,000	9,000

Estimates of capital financing requirement	General Services £000	HRA £000	Total £000	Annual Movement £000
2011/12	255,674	168,202	423,876	36,102
2012/13	292,000	177,000	469,000	45,124
2013/14	321,000	179,000	500,000	31,000
2014/15	333,000	178,000	511,000	11,000
2015/16	355,000	177,000	532,000	21,000
2016/17	363,000	178,000	541,000	9,000

Difference between net borrowing and capital financing requirement	Total £000
2011/12	41,293
2012/13	36,000
2013/14	36,000
2014/15	36,000
2015/16	36,000
2016/17	36,000

Incremental impact of capital investment decisions
(Increase in Council Tax per Report 144-2011 - Treasury Management Strategy & Annual Investment Strategy 2011/2012)

	Increase in Council Tax (Band D) per annum (£)	Increase in average housing rent per week (£)
2011/12	0.0	1.43
2012/13	0.05	1.07
2013/14	0.75	0.33
2014/15	1.55	(0.11)
2015/16	0.47	(0.16)
2016/17	4.52	0.21

APPENDIX B

OUTLOOK FOR INTEREST RATES

The data below shows a variety of forecasts published by a number of institutions. These are individual forecasts including those of UBS and Capital Economics (an independent forecasting consultancy).

The forecast within this strategy statement has been drawn from these diverse sources and officers' own views.

Sector's Interest Rate View														
	Now	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Sector's Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%
3 Month LIBID	0.38%	0.50%	0.50%	0.50%	0.50%	0.50%	0.60%	0.60%	0.70%	0.80%	1.10%	1.40%	1.70%	1.90%
6 Month LIBID	0.50%	0.70%	0.70%	0.70%	0.70%	0.70%	0.80%	0.90%	1.00%	1.10%	1.30%	1.60%	1.90%	2.20%
12 Month LIBID	0.83%	1.00%	1.00%	1.00%	1.00%	1.10%	1.10%	1.20%	1.30%	1.30%	1.50%	1.80%	2.10%	2.40%
5yr PWLB Rate	1.88%	1.80%	1.80%	1.80%	1.80%	1.90%	2.00%	2.10%	2.20%	2.40%	2.50%	2.60%	2.80%	3.00%
10yr PWLB Rate	3.09%	2.90%	2.90%	2.90%	2.90%	3.00%	3.10%	3.20%	3.30%	3.50%	3.60%	3.80%	3.90%	4.10%
25yr PWLB Rate	4.24%	4.10%	4.10%	4.10%	4.10%	4.20%	4.20%	4.30%	4.40%	4.60%	4.60%	4.80%	4.90%	5.00%
50yr PWLB Rate	4.39%	4.20%	4.20%	4.20%	4.20%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%
Bank Rate														
Sector's View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%
UBS	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	–	–	–	–	–
Capital Economics	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	–	–	–	–	–
5yr PWLB Rate														
Sector's View	1.88%	1.80%	1.80%	1.80%	1.80%	1.90%	2.00%	2.10%	2.20%	2.40%	2.50%	2.60%	2.80%	3.00%
UBS	1.88%	–	–	–	–	–	–	–	–	–	–	–	–	–
Capital Economics	1.88%	1.55%	1.30%	1.30%	1.30%	1.30%	1.30%	1.50%	1.60%	–	–	–	–	–
10yr PWLB Rate														
Sector's View	3.09%	2.90%	2.90%	2.90%	2.90%	3.00%	3.10%	3.20%	3.30%	3.50%	3.60%	3.80%	3.90%	4.10%
UBS	3.09%	3.00%	3.10%	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	–	–	–	–	–
Capital Economics	3.09%	2.55%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	–	–	–	–	–
25yr PWLB Rate														
Sector's View	4.24%	4.10%	4.10%	4.10%	4.10%	4.20%	4.20%	4.30%	4.40%	4.60%	4.60%	4.80%	4.90%	5.00%
UBS	4.24%	4.20%	4.30%	4.40%	4.50%	4.50%	4.50%	4.50%	4.50%	–	–	–	–	–
Capital Economics	4.24%	3.70%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	–	–	–	–	–
50yr PWLB Rate														
Sector's View	4.39%	4.20%	4.20%	4.20%	4.20%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%
UBS	4.39%	4.30%	4.40%	4.50%	4.60%	4.60%	4.60%	4.60%	4.60%	–	–	–	–	–
Capital Economics	4.39%	4.00%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	–	–	–	–	–

APPENDIX C

PERMITTED INVESTMENTS

This Council approves the following forms of investment instrument for use as permitted investments as set out in Table 1.

Treasury risks
All the investment instruments in Table 1 are subject to the following risks: -

1. **Credit and counterparty 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.

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. This authority has set limits for its fixed and variable rate exposure in its Treasury Indicators in this report.

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 counterparty risk:** this authority 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:** this authority 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:** this authority does not purchase investment instruments which are subject to market risk in terms of fluctuation in their value. (The only exception is for Common Good and Insurance Fund assets where there is a slightly higher risk threshold).

4. **Interest rate risk**: this authority 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:** this authority 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

Regulation 24 states that an investment can be shown in table 1 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 authority has given no types of investment an unlimited category.

Objectives of each type of investment instrument

Regulation 25 requires an explanation of the objectives of every type of investment instrument which an authority approves as being 'permitted'.

1. 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.** (DMADF) 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.

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 authority feels that the residual risks around using such banks and building societies are at a low, reasonable and acceptable level. The authority will ensure diversification of its portfolio of deposits ensuring that no more than £12m can be placed with any one institution or group.

c. **Call accounts with high credit worthiness banks and building societies.** The objectives are as for 1b. 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. Some use of call accounts is highly desirable to ensure that the authority has ready access to cash when needed to pay bills. This is likely to be the most widely used in 2013/14.

2. 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).** By definition, MMFs are AAA rated and are widely diversified, using many forms of money market securities including types which this authority 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. They are particularly advantageous in falling interest rate environments as their 60 day WAM means they have locked in investments earning higher rates of interest than are currently available in the market. MMFs also help an authority to diversify its own portfolio as e.g. a £2m investment placed directly with HSBC is a 100% risk exposure to HSBC whereas £2m invested in a MMF may end up with say £10,000 being invested with HSBC through the MMF. For authorities particularly concerned with risk exposure to banks, MMFs offer an effective way of minimising risk exposure while still getting much better rates of return than available through the DMADF. They also offer a constant Net Asset Value (NAV) i.e. the principal sum invested has high security.

c. **Gilt funds.** (Common Good and Insurance Fund Only) 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.

d. **Bond funds.** (Common Good and Insurance Fund Only) 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.

e. **Equity funds** (Common Good and Insurance Fund Only) These invest in equities actively traded in the UK. They potentially offer a higher rate of return than both gilts and bonds. This therefore entails a higher level of risk exposure. They do have increased exposure to movements in market prices of assets held so do not offer constant Net Asset Value.

3. 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 or access to cash at any point in time. However, there is a spread between purchase and sales 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.

4. OTHER

a. **Equities.** Only equities which are actively traded in the UK are invested in for Treasury purposes. They potentially offer a higher rate of return than both gilts and bonds. This therefore entails a higher level of risk exposure. They do have increased exposure to movements in market prices of assets held so do not offer constant Net Asset Value.

Equities may be purchased for service reasons in local companies. These will carry a higher level of risk.

b. **Loans to Third Parties.** Loans issued to third parties are treated as investments. These loans are normally offered at prevailing market rates but may on occasion for service reasons be offered at an interest rate below the market rate.

Table 1: Permitted investments in house

1.1 Deposits

	Minimum Credit Criteria	Liquidity Risk	Market Risk	Max	Max. maturity period
Debt Management Agency Deposit Facility	-	term	no	£12m	1yr
Term deposits - Local Authority	-	term	no	£8m	1yr
Call accounts - banks and building societies	per Sector Matrix	instant	no	£12m	1yr
Term deposits - banks and building societies	per Sector Matrix	term	no	£12m	1yr
Fixed term deposits with variable rate and variable maturities: - Structured deposits.	per Sector Matrix	term	no	£12m	1yr

1.2 Collective investment schemes structured as Open Ended Investment Companies (OEICs)

	Minimum Credit Criteria	Liquidity Risk	Market Risk	Max % of total investments	Max. maturity period
1. Government Liquidity Funds	Long-term volatility rating V1-V2	instant	no (see note A)	50%	60 days
2. Money Market Funds	Long-term volatility rating $AAA_{MM}f$	instant	no (see note A)	50%	60 days
3. Gilt Funds (Common Good and Insurance Only)	Long-term volatility rating V1-V2	T+>1	yes	50% of Common Good or Insurance only	ongoing
4. Bond Funds (Common Good and Insurance Only)	Long-term volatility rating V1-V4	T+>1	yes	50% of Common Good or Insurance only	ongoing
5. Equity Funds (Common Good and Insurance Only)	*Long-term volatility rating V1-V7	T+>1	yes	50% of Common Good or Insurance only	ongoing

Note A: the objective of this fund to maintain the net asset value but they hold assets which can vary in value. However, the credit rating agencies require the fluctuation in unit values held by investors to vary by almost zero.

1.3 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	20	1yr
UK Government	UK sovereign rating	Sale T+1	yes	20	1yr
Bond issuance by a financial institution which is explicitly guaranteed by the UK Government (refers solely to GEFCO - Guaranteed Export Finance Corporation)	UK sovereign rating	Sale T+3	yes	20	1yr

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

1.4 Other

	*Minimum Credit Criteria	Liquidity Risk	Market Risk	Max %/value of total investments	Max. maturity period
Equities	FTSE 350	T+3	yes	50% of Common Good or Insurance only	ongoing
Loans to Third Parties	-	term	no	£20m	ongoing
Equities for Services Reasons	-	inherent	No	£1m	ongoing

APPENDIX D

TREASURY MANAGEMENT

The Director of Corporate Services and her staff shall ensure that all the Council's. borrowing and lending transactions and practices comply with the CIPFA Code of Practice on Treasury Management in the Public Services.

The Director of Corporate Services shall prepare a Treasury Policy Statement which will be approved by the Policy and Resources Committee and reviewed at least every three years.

The Director of Corporate Services shall prior to the commencement of each financial year submit a report to the Policy and Resources Committee on the Treasury Management Strategy for that year.

The Director of Corporate Services shall submit a report to the Policy and Resources Committee twice yearly reviewing the Council's Treasury Management activities. One of these reports will be an annual report on the Treasury Management activities of the previous financial year.

APPENDIX E

INVESTMENT FORECASTS	2011/12	2012/13	2013/14	2014/15	2015/16
	Actual	Probable Outturn	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Cash balances managed in house					
1 April	12,300	6,650	5,650	5,000	5,000
31 March	6,650	5,650	5,000	5,000	5,000
change in year	(5,650)	(1,000)	(650)	0	0
average daily cash balances	20,879	18,000	5,000	5,000	5,000
Cash balances managed by cash fund managers					
1 April	0	0	0	0	0
31 March	0	0	0	0	0
change in year	0	0	0	0	0
average daily cash balances	0	0	0	0	0
TOTAL CASH BALANCES					
1 April	12,300	6,650	5,650	5,000	5,000
31 March	6,650	5,650	5,000	5,000	5,000
change in year	(5,650)	(1,000)	(560)	0	0
average daily cash balances	20,879	18,000	5,000	5,000	5,000
Holdings of shares, bonds, units (including authority owned company)					
1 April	991	1,073	1,073	1,073	1,073
purchases	0	0	0	0	0
sales	0	0	0	0	0
capital gain/(loss)	82	0	0	0	0
31 March	1,073	1,073	1,073	1,073	1,073
Loans to local authority owned company or other entity to deliver services					
1 April	0	0	0	0	0
advances	0	0	0	0	0
repayments	0	0	0	0	0
31 March	0	0	0	0	0
Loans made to third parties					
1 April	10,861	11,127	11,286	11,326	11,276
advances	969	1,000	1,000	1,000	1,000
repayments	703	841	960	1,050	1,116
31 March	11,127	11,286	11,326	11,276	11,160
Investment properties					
1 April	19,360	19,360	19,360	19,360	19,360
advances	0	0	0	0	0
repayments	0	0	0	0	0
31 March	19,360	19,360	19,360	19,360	19,360
TOTAL OF ALL INVESTMENTS					
1 April	43,512	38,210	37,369	36,759	36,709
31 March	38,210	37,369	36,759	36,709	36,593
change in year	(5,384)	(841)	(610)	(50)	(116)