Report to:
Audit and corporate governance committee
Cabinet
Council

Report of Head of Finance

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To: Audit & Corporate Governance Committee 29 January 2013
To: Cabinet 14 February 2013
To: Council 21 February 2013

Treasury management strategy 2013/14 to 2015/16

Recommendations:

That audit and corporate governance committee:

1. Scrutinise the treasury management strategy and policy and if required make recommendations for amendment to cabinet.

That cabinet recommends council to approve:

2. the treasury management strategy 2013/14 to 2015/16, incorporating the annual investment strategy, which is contained within appendix A of the report of the head of finance to cabinet on 14 February 2013,

3. The prudential indicators and limits for 2013/14 to 2015/16, which are contained within appendix A of the report of the head of finance to cabinet on 14 February 2013.

Purpose of report

1. This report presents the council's Treasury Management Strategy (TMS) for 2013/14 to 2015/16 and sets out the expected treasury operations for this period. It comprises of four elements required by legislation as follows:

- The prudential indicators required by the CIPFA Prudential Code for Capital Finance in Local Authorities (paragraph 8, table 2);
- The treasury management strategy in accordance with the CIPFA Code of Practice on Treasury Management. This sets out how the council's treasury service will support capital investment decisions, and how the treasury management operates day to day. Its sets out the limitations on treasury management activity through prudential indicators, within which the council's treasury function must operate. The strategy is included as appendix A to the report (paragraphs 1-49);
- The annual investment strategy. This sets out the council's criteria for selecting counterparties and limiting exposure to the risk of loss on its investments. This strategy is in accordance with the DCLG investment guidance and forms part of the treasury management strategy. (appendix A, paragraphs 20 – 49);
- A statutory duty to approve a minimum revenue provision policy for 2013/14 (paragraphs 44-45).

It is a requirement of the CIPFA 2011 Treasury Management Code that this report is approved by Full Council on an annual basis.

Strategic objectives

2. Effective treasury management is required in order to meet our strategic objective of managing our business effectively. Managing the finances of the authority in accordance with the treasury management strategy will help to ensure that resources are available to deliver its services and meet the council's other strategic objectives.

Background

3. Treasury management is the management of the council's 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.

4. The funding of the council's capital expenditure is also a function of treasury management. The capital programme provides a guide to the funding needs of the council and the long term cash flow plans to ensure that the council can meet its capital spending obligations.

5. The treasury management and annual investment strategy set out the council's policies for managing investments and confirms the council gives priority to the security and liquidity of those investments. It also includes the prudential indicators for the next three years; these demonstrate that the council's capital investment plans are affordable, prudent and sustainable.

6. The council could choose to adopt a totally risk adverse strategy and place all its investments in the government's debt management account. Although this would all but eliminate the possibility of repayment default, it would also result in a poor return on investment. Should the council have adopted such a strategy over the past 10 years it would have earnt £60m less in interest than its adopted strategy delivered. The council therefore sets a strategy that takes marginal risk in return for greater reward.

7. The council's treasury management strategy 2013/14 to 2015/16 is attached in appendix A. Whilst every attempt has been made to minimise the technical content of this report, by its very nature and the need for compliance with associated guidance the report is technical in parts. A glossary of terms in annexe 6 should aid members understanding of some technical terms used in the report.

Recommended changes to the treasury management strategy

8. The biggest operation challenge for officers is to find suitable counter-parties to lend to. As credit rating fall across the board so the options available to officers reduce. The larger, higher rates institutions will not deal in the (relatively) small sums our lending limits impose and so we must look to amending our lending criteria to allow us to place amounts with a larger range of institutions. These recommendations address this reality.

9. Council approved the 2012/13 treasury management strategy on 22 February 2012. The proposed strategy for 2013/14 includes the changes detailed below, which cabinet is asked to recommend to council:

   a. Building societies – more detailed criteria for investment amounts and maturity periods have been set out linked to the asset base of building societies:

      1) Current:
         - Assets over £1bn with a F1 credit rating – we can lend £15m for up to one year
         - Assets over £1bn but unrated – we can lend £15m for up to nine months
         - Assets over £500m but unrated – we can lend £10m for up to six months

      2) Proposed:
         - Assets over £5bn but unrated - we can lend up to £15m for up to one year
         - Assets over £1bn but unrated - we can lend up to £10m for up to ten months
         - Assets over £500m but unrated – we can lend up to £6m for up to nine months
         - Assets over £0.25bn but unrated – we can lend up to £4m for up to six months

      The building society sector has been largely unaffected by the credit issues that have affected the banking sector. Societies' business model is relatively simple and transparent in comparison with banks, with a culture focused on their customers. They are strictly regulated by the building societies Act 1986 within which funding and lending limits control how much of the business is secured in residential property and shares held by individuals. The changes proposed above will add a further 11 building societies to the counterparty list.

   b. Housing Associations – a new category has been set for investments to be made in this sector up to £15 million. Officers are currently exploring the options of this type of investment which would be either through the purchase of corporate bonds and linked to a credit rating of the institution or an investment which would be appropriately secured on the assets.

   c. Institutions individual and support ratings criteria removed. – Rated instiutions are given individual and support ratings and our previously approved limits set out criteria for these ratings. The ratings agencies have in the main downgraded most financial institutions and the support ratings do not reflect any government support provided. This distorts the criteria if used, as it is clear that the UK government has provided a guarantee scheme and financial support to the financial sector. Additional data is now used to support the assessment of counterparties further details are provided in paragraphs 33 to 39 of appendix A.

Financial implications and risk assessment

10. This report and all associated policies and strategies set out the parameters the council must work within. It is important that the council follows the approved treasury management strategy which is designed to protect the council's finances by managing its risk exposure.

11. In the last few years investment income has fallen due to falling interest rates. In the medium term interest rates are expected to rise. The table below gives an estimate of the amounts available for investment, and the investment income achievable for the next four years.

Table 1: Medium term investment income forecast.

	2012/13	2013/14	2014/15	2015/16	2016/17
	£000's	£000's	£000's	£000's	£000's
Estimate of average investments	115,500	97,337	92,904	89,380	85,303
Forecast average interest rate	2.26%	2.00%	2.25%	2.50%	3.00%
December 2012 forecast investment income	2,605	1,947	2,090	2,235	2,559

The 2013/14 budget setting report takes into account the latest projections of anticipated investment income.

Legal implications

12. There are no significant legal implications as a result of the recommendations in this report. Compliance with the CIPFA Code of Practice for Treasury Management in the Public Services, the ODPM Local Government Investment Guidance provides assurance that the council's investments are, and will continue to be, within its legal powers.

13. The council must approve any amendment to the treasury management strategy and annual investment strategy in accordance with the Local Government Act 2003 (the Act), the CIPFA Code of Practice for Treasury Management in the Public Services and the ODPM Local Government Investment Guidance under Section 15(1) (a) Local Government Act 2003 and CIPFA Prudential Code for Capital Finance.

Conclusion

14. This report provides details of the proposed changes to the treasury management strategy and the annual investment strategy for 2013/14 which are appended to this report, together with the prudential indicators for approval to council. These documents provide the parameters within which officers will operate the council's treasury management function.

Appendices

Appendix A	Treasury Management Strategy 2013/14 – 2015/16
Annex 1	Economic conditions and prospects for interest rates
Annex 2	Risk and performance benchmarking
Annex 3	Property investment policy
Annex 4	Explanation of prudential indicators
Annex 5	TMP1
Annex 6	Glossary of terms

Treasury Management Strategy 2013/14 to 2015/16

Introduction

1. The Local Government Act 2003 and supporting regulations require the council to 'have regard to' the CIPFA Prudential Code and to set Prudential Indicators for the next three years to ensure that the council's capital investment plans are affordable, prudent and sustainable.
2. The Act requires the council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act). This sets out the council's policies for managing its investments and for giving priority to the security and liquidity of those investments.
3. The strategy in respect of the following aspects of the treasury management function is based on treasury officers' views on interest rates, supplemented with market forecasts provided by the council's treasury advisor, Sector Treasury Services. The strategy covers:
   - Prudential and treasury indicators in force that will limit the treasury risk and activities of the council;
   - Current treasury position
   - Borrowing strategy
   - Policy on borrowing in advance of need;
   - Investment strategy;
   - Counterparty selection and limits;
   - Policy on use of external service providers;
   - Minimum revenue Provision (MRP) statement;
   - Treasury management scheme of delegation and Section 151 role.

4. It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each year to include the revenue costs that flow from capital financing decisions. This means that increases in capital expenditure must be limited to a level where any increases in charges to revenue from:
   - Increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
   - Any increases in running costs from new capital projects

   are identified and limited to a level which is affordable.

A key requirement of the strategy is to explain the risks, and the management of those risks, associated with providing the treasury service. Legislation requires that as a minimum two further treasury reports are provided: a mid-year monitoring report and an outturn report after the year-end that reports on actual activity for the year.

Treasury Limits for 2013/14 to 2015/16

5. It is a statutory duty, under Section 3 of the Act and supporting regulations for the council to determine and keep under review how much it can afford to borrow. The amount so determined is called the “Affordable Borrowing Limit”. The Authorised Limit is the legislative limit specified in the Act.
6. The council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital expenditure remains within sustainable limits and in particular, that the impact upon its future council tax is ‘acceptable’.
7. The Authorised Limit is set on a rolling basis, for the forthcoming financial year and two successive financial years.

Cabinet is asked to recommend council to approve the limits set out in table 2:

Table 2: Prudential indicators	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Debt	**£m**	**£m**	**£m**	**£m**
Authorised limit for external debt				
Borrowing	5	5	5	5
Other long term liabilities	5	5	5	5
	10	**10**	**10**	**10**
Operational boundary for external debt				
Borrowing	2	2	2	2
Other long term liabilities	3	3	3	3
	5	**5**	**5**	**5**
Interest rate exposures				
Maximum fixed rate borrowing	nil	100%	100%	100%
Maximum variable rate borrowing	nil	100%	100%	100%
Investments				
Interest rate exposures				
Limits on fixed interest rates	100	100	100	100
Limits on variable interest rates	30	30	30	30
Principal sums invested > 364 days				
Upper limit for principal sums invested >364 days	70	70	70	70
Limit to be placed on investments to maturity:				
1 - 2 years	70	70	70	70
2-5 years	50	50	50	50
5 years+	50	50	50	50
Investment portfolio spread - (upper limits)				
Supranational bonds	15	15	15	15
Gilts	15	15	15	15
Equities*	10	10	10	10
Corporate bonds	10	10	10	10
Money market funds	20	20	20	20
Pooled bond fund	5	5	5	5
Property - direct investments	30	30	30	30
Property related pooled funds	10	10	10	10
External fund manager	20	20	20	20
Cash and certificates of deposit	85%	85%	85%	85%
Debt management account deposit facility	100%	100%	100%	100%
*Limit at time of purchase - Equities include accumulated dividends				

8. The indicators set the parameters within which we manage the overall capital investment and treasury management functions. The specific treasury activity limits aim to contain the activity of the treasury function in order to manage risk and reduce the impact of an adverse movement in interest rates. However if these are set to be too restrictive they will impair the opportunities to reduce costs/improve performance. Explanations for the indicators can be found in Annex 4 of the report.

Current position

9. The council's investments at 31 December 2012 were as follows:

Table 3: maturity structure of investments at 31 December 2012:	Total £000's	% holding
Cash deposits:		
Call accounts	23,022	18%
Notice account	1	0%
Up to 1 month	2,000	2%
2 Month	12,000	10%
3 Month	7,500	6%
4 Month	4,000	3%
5-6 Month	11,500	9%
7-12 Month	37,000	30%
1 -2 Year	3,500	3%
2-5Year	3,000	2%
Kaupthing Singer & Friedlander	500	1%
Total cash deposits	**104,023**	84%
Equities	12,481	10%
Corporate bonds	4,174	3%
Money market funds	3,990	3%
Total investments	**124,669**	**100%**

10. The council currently holds 84 per cent of its investments in the form of cash deposits, 60 per cent is invested for fixed terms with a fixed investment return and 18 per cent is currently held on call accounts, with the remainder held in non cash deposits. Typically the council restricts lending activity to UK institutions and the highest rated counterparties.

Icelandic banks – Kaupthing Singer & Friedlander

11. The council has now received £1,999,767 in respect of the claim for £2.6 million (£2.5 million investment plus interest) from the investment made with the failed Icelandic bank Kaupthing Singer & Friedlander (KSF).

12. The administrators intend to make further payments at regular intervals. The latest information states that it is the administrators' current intention to pay the tenth dividend in approximately six months' time. The estimated total amount to be recovered is forecast to be in the range of 81p to 86p in the pound. This equates to between £2,130,975 and £2,262,517

Investment performance for the year to 31 December 2012.

13. The council's budgeted investment return for 2012/13 is £2.5 million, and the actual interest earned to date is shown as follows:

Table 4: Investment interest earned by investment type				
	Interest Earned 2012/13			
Investment type	Annual Budget £000's	Actual To date £000's	Annual Forecast £000's	Variation £000's
Call accounts	43	75	90	47
Cash deposits < 1 yr	1057	426	545	(512)
Cash deposits > 1 yr	705	918	1171	466
MMF	30	26	32	2
Corporate bonds	411	298	395	(16)
Transferred debt	10	0	10	(10)
Equities	250	453	362	112
Total interest	**2,506**	**2,196**	**2,605**	**89**

Borrowing Strategy 2013/14 – 2015/16

14. The council has to provide details of its borrowing requirement, any maturing debt which will need to be re-financed, and the effect this will have on the treasury position over the next three years. This council has no external debt and does not expect to borrow long term to finance the current capital programme. The council will continue to take a prudent approach to its debt strategy. In general, the council will borrow for one of two purposes:

    - To finance cash flow in the short-term;
    - To fund capital investment over the medium to long term.

15. The prudential indicators and limits for debt are set out in table 2 and provide the scope and flexibility for the council to borrow in the short-term up to a maximum of £10 million, if such a need arose within the cash flow management activities of the authority, for the achievement of its service objectives. The council's capital investment plans do not currently demonstrate a need to borrow, as all projects are fully funded.

16. The bank rate is expected to remain at a historically low level for another year. This does provide a window of opportunity to review the strategy of undertaking external borrowing for new projects.

17. The treasury management strategy for the forthcoming year aims to efficiently manage the investment portfolio by reducing the amount of funds held extremely short-term for cash flow purposes and operating with an adequate but not excessive level of working capital. This optimum level is dictated by the accuracy of cash flow forecasts and, although unlikely, it is prudent to set a minimum level for the use of short-term borrowing arrangements or overdraft facilities if the cash flow forecasts prove inaccurate at any point in the year.

18. The head of finance, would in such instances take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above.

Policy on borrowing in advance of need

19. 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. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure value for money can be demonstrated and that the council can ensure the security of such funds. In determining if any borrowing will be undertaken in advance of need, the council will:

    - Consider the impact of borrowing in advance on investment cash balances and the exposure to counterparty risk. Any risk associated with any borrowing in advance of activity will be subject to prior appraisal and subsequent reporting through the mid year or annual reporting process.

Annual investment strategy

20. The main aim of the council's investment strategy is to maintain the security and liquidity of its investments, although the yield or return on the investment will be a consideration, subject to adequate security and liquidity. The council will ensure:

    - It has sufficient liquidity in its investments to cover cash flow. For this purpose it has set out parameters for determining the maximum periods for which funds may prudently be committed.

    - It maintains a policy covering the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security.

21. The strategy aims to provide a high degree of flexibility to take appropriate lending decisions, with a view to producing a portfolio with an even spread of maturity periods as and when institutional security and market confidence returns. This aim is to provide a more even and predictable investment return in the medium term.

22. The head of finance will ensure a counterparty list (a list of named institutions) is maintained in compliance with the recommended credit rating criteria (table 6) and will revise the criteria and submit any changes to the credit rating criteria to council for approval as necessary.

Investment types

23. The types of investment that the council can use are summarised below. These are split under the headings of specified and non-specified in accordance with the statutory guidance.

Specified investment instruments (maximum period 1 year)

- Deposits with banks and building societies
- Deposits with UK local authorities
- UK Government – treasury stock (Gilts) with less than one year to maturity
- Debt Management Agency Deposit Facility (DMADF)
- Money Market Funds (MMF) (AAA rated)
- Pooled Bond funds (AAAf rated)
- Certificates of deposits issued by banks and building societies

Non-specified investment instruments (maturities over one year)

- Bank and building society cash deposits up to 5 years
- Deposits with UK local authorities up to 5 years
- Corporate bonds
- Pooled property, bond funds and UK pooled equity funds
- UK treasury stock (Gilts) up to 10 years
- Supranational bonds up to 10 years
- Direct property investment

Other Non-specified investment instruments

- Fixed term deposits with variable rate and variable maturities
- Investment in Housing Associations

Approach to investing

24. The council currently holds approximately £85 million core cash balances which are available to invest for more than one year. This is expected to reduce over the medium term as the approved capital expenditure is carried out. In addition the council has funds which are available on a temporary basis to invest. These are held pending payment over to another body such as precept payments and council tax. The amount can vary between £15 million and £30 million throughout the year and can only be invested short term (under one year). Investments will be made primarily with reference to known cash flow requirements.

25. Whilst the economic and market uncertainties remain, the council will keep investments relatively short term, but where possible will continue to look for opportunities to fix lending in the medium term with highly rated institutions when possible for core cash balances. The aim is to increase the weighted average maturity of the portfolio in order to reduce maturity risk, and provide certainty of return and smoothing of the investment profile.

26. Conditions in the financial sector have begun to show signs of improvement, with substantial intervention by the government. Officers will continue to implement an operational strategy which provides tight controls on the investments placed. As a result of a sharp decline in the number of acceptable counterparties, the limits incorporate changes to the councils exposure for both types of investment and time limits. These changes aim to give greater flexibility to improve the spread the investment risk over different types of instruments and sectors, subject to a full assessment of risk and security.

27. The revised limits are shown in detail in table 5. The changes to the previously approved limits are:

   a. Institutions individual and support ratings criteria removed. – The previously approved limits set out criteria for individual and support ratings. The ratings agencies have in the main downgraded most financial institutions and the support ratings do not reflect any government support provided. This distorts the criteria if used, as it is clear that the UK government has provided a guarantee scheme and financial support to the financial sector.

b. Housing Associations – a new category has been set for investments to be made in this sector up to £15 million. Officers are currently exploring the options of this type of investment which would be either through the purchase of corporate bonds and linked to a credit rating of the institution or an investment which would be appropriately secured on the assets of the institution.

c. Building societies – more detailed criteria for investment amounts and maturity periods have been set out linked to the asset base of building societies:

3) Current:
- Assets over £1bn with a F1 credit rating – we can lend £15m for up to one year
- Assets over £1bn but unrated – we can lend £15m for up to nine months
- Assets over £500m but unrated – we can lend £10m for up to six months

4) Proposed:
- Assets over £5bn but unrated - we can lend up to £15m for up to one year
- Assets over £1bn but unrated - we can lend up to £10m for up to 10 months
- Assets over £500m but unrated – we can lend up to £6m for up to nine months
- Assets over £0.25bn but unrated – we can lend up to £4m for up to six months

The building society sector has been largely unaffected by the credit issues that have affected the banking sector. Societies' business model is relatively simple and transparent in comparison with banks, with a culture focused on their customers. They are strictly regulated by the building societies Act 1986 within which funding and lending limits control how much of the business is secured in residential property and shares held by individuals. The changes proposed above will add a further 11 building societies to the counterparty list.

28. Should market conditions deteriorate suddenly to the extent that the council is unable to place money with institutions with the necessary credit rating, it will make use of the UK Government deposit account (DMADF).

29. The property investment holdings will also be looked at in more detail for consideration. Further details on the property investment policy are contained in annex 3.

30. There will be no further investment using a fund manager at this time. However, this will be kept under review.

31. Bond funds can be used to diversify the portfolio, whilst maintaining liquidity and security. These will be considered and reviewed as an investment possibility to spread portfolio risk.

Counterparty selection

32. Treasury management risk is the risk of loss of capital to the council. To minimise this risk, the council uses credit rating information when considering who to lend to. Sector provides the council with credit rating updates from all three ratings agencies – Standard & Poors, Fitch and Moodys.

33. The council is also required to supplement the credit rating data with operational market information such as credit default swaps (CDS), negative watches and outlooks, which are considered when assessing the security of counterparties. This additional information is used so that the council does not rely solely on the current credit ratings of counterparties.

34. The council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine the creditworthy counterparties. This is because Moodys have become far more aggressive in allocating low ratings than the other two agencies. If followed, this approach would leave the council with so few institutions on its approved lending list it would be unworkable. The information provided by Sector uses a wider array of information than just primary ratings and does not give undue weight to any one agency's ratings. Credit information is updated and monitored weekly, supplemented by daily emails, which are consulted prior to making an investment decision. The council is alerted to any changes from all three agencies through the use of data provided by Sector. If a downgrade results in the counterparty no longer meeting the council's minimum criteria, it will not be used for future investments. Movements in CDS and other market data is also reviewed on a weekly basis. Extreme market movements may result in a downgrade of an institution or removal from the council's lending list.

35. Where it is felt the council would benefit from utilising government guarantees provided by countries with an AAA rating, the council may lend to institutions covered by such guarantees. Any decision to lend in this way will be subject to consultation with and the agreement of the cabinet member responsible for finance.

Country and sector considerations

36. The council has determined that it will only use approved counterparties outside the UK from countries with a minimum sovereign credit rating of AAA from Fitch Ratings.

Counterparty limits

37. In the normal course of the council's cash flow operations it is expected that both specified and non-specified investments will be used for the control of liquidity as both categories allow for short term investments. The use of longer term instruments (greater than one year from inception to repayment) will fall in the non-specified investment category. These instruments will be used where the council's liquidity requirements are safeguarded. The council will lend to institutions that meet the following criteria:

Table 5: Counterparty limits

Counterparty	FITCH or equivalent S/term	FITCH or equivalent L/term	Govt guarantee	Max limit per counterparty £m	Max. Maturity period	Max % of total investments
Specified instrument:						
Institutions with a minimum rating	F1	A-		£15m	1 year	50%
Bank / BS cash deposits(2)			UK Sovereign	£15m	Term of guarantee	Term of guarantee
Bank - part nationalised UK			UK Sovereign	£20m	l year	l year
Money Market Fund	AAA			£5m	liquid	100%
UK Govt & DMADF	n/a		UK Sovereign	no limit	n/a	100%
Non-specified instrument:						
Building societies - assets > £5,000m	n/a			£15m	12 months	20%
Building societies - assets > £1,000m				£10m	10 months	20%
Building societies - assets > £500m	n/a			£6m	9 months	10%
Building societies - assets > £250m				£4m	6 months	10%
Bond fund		AAA		£15m	variable	40%
Institutions with a minimum rating	F1+	AA-		£15m	4 years	25%
Institutions with a minimum rating	F1+	A+		£15m	3 years	25%
Institutions with a minimum rating	F1	A		£15m	2 years	30%
Bank subsidiary	unconditional guarantee			£15m		as parent
Bank - part nationalised UK			UK Sovereign	£20m	4 years	80%
Pooled property fund				£10m	variable	15%
Housing associations	F1+	A+		£15m	variable	15%
UK equities				£10m	variable	20%
Corporate bonds	F1+	A+		£5m	variable	10%
Property related investments				£30m	variable	80%
Local Authorities / parish councils				£15m	5 years	50%
Supranationals		AAA		£10m	10 years	40%
UK government - gilts			UK Sovereign	£15m	15 years	10%

* Bank subsidiary limits will depend on the relationship between themselves and their parent bank. A subsidiary will only be included on the counterparty list if some form of guarantee exists between it and the parent entity.

38. The criteria for choosing counterparties provides a sound approach to investment in "normal" market circumstances. The head of finance may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval. These restrictions will remain in place until the banking system returns to "normal" conditions.

Fund managers

39. The treasury management strategy allows for a total of up to £15 million portfolio to be invested with a fund manager. Fund managers can invest in a variety of investment types such as cash deposits, gilts and certificates of deposits. These types of funds can extend the spread of investment portfolio, access highly rated institutions and capitalise upon opportunities to improve returns, whilst maintaining liquidity. This is reviewed regularly, and at present it is not evident that the council can currently benefit from the service of a fund manager due to the market conditions. However, the situation will continue to be reviewed.

Risk and performance benchmarks

40. A requirement of the code is that security and liquidity benchmarks are considered and approved. This is in addition to yield benchmarks which are used to assess performance. The benchmarks are guidelines (not limits) so may be breached depending on the movement in interest rates and counterparty criteria. Their purpose is to allow officers to monitor the current trend position and amend the operational strategy depending on any changes. Any breach of the benchmarks will be reported, with an explanation in the mid year or annual report to audit and corporate governance committee. Detailed information for the assessment of risk is shown in annexe 2.

41. Performance indicators are set to assess the adequacy of the treasury function over the year. These are distinct historic performance indicators, as opposed to the predominantly forward looking prudential indicators. The indicators used to assess the performance of the treasury function are:

Table 6: investment benchmarks

Investment category	Benchmark
Bank & building society deposits - non-managed	3 Month LIBID
Equities	FTSE all shares index
Property related investments	IPD balanced Property Unit Trust Index
Corporate bonds	BoE base rate

Performance against these indicators will be reported in both the annual mid-year and year-end treasury reports.

Policy on the use of treasury management advisers

42. The council has a joint contract for treasury management advisors with Vale of White Horse District Council. A three year contract was awarded to Sector Treasury Services Limited, a subsidiary of the Capita Group Plc in October 2011. The company provides a range of services which include:

- technical support on treasury matters, capital finance issues member reports;
- economic forecasts and interest rate analysis;
- credit ratings / market information service involving the three main credit rating agencies;
- provision of credit rating information, strategic advice including a review of the investment and borrowing strategies and policy documents.

43. Following the collapse of the Icelandic banks, and the subsequent local authority exposure to these defaults, the revised CLG investment guidance notes and the CIPFA Treasury Code of Practice requires the council to recognise that responsibility for treasury management decisions remains with the council at all times and to ensure that undue reliance is not placed upon external service providers. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources.

Minimum revenue provision (MRP) statement 2013/14

44. The council is required to assess its MRP requirement for the year in accordance with the guidance of section 21 of the Act. MRP is a charge made to the revenue account as a proportion of outstanding capital liabilities. The council has no outstanding capital liability and therefore the MRP for 2013/14 is nil.

45. This will remain the case unless new capital expenditure is financed by borrowing.

Member and officer training

46. The requirement for increased member consideration of treasury management matters and the need to ensure officers dealing with treasury management are trained and kept up to date requires a suitable training process for members and officers. In compliance with the revised code, the council has provided treasury management training to members in January 2012.

Treasury management scheme of delegation and the role of the section 151 officer

The treasury management scheme of delegation and the role of the section 151 officer is as follows:

I. **Council**
   - Receiving and approval of reports on treasury management policies, practices and activities;
   - Approval of annual treasury management strategy and annual investment strategy

II. **Audit and governance Committee / Cabinet**
   - Approval of /amendments to the organisations adopted clauses, treasury management policy statements and treasury management practices;
   - Receiving and reviewing monitoring reports and acting on recommendations;

III. **Section 151 Officer / Head of Finance**
   - Recommending clauses, treasury management policies/practices for approval, review and monitoring compliance;
   - Submitting regular treasury management information reports;
   - Submitting budgets and budget variations;
   - Reviewing the performance of the treasury management function;
   - Ensuring 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;
   - Approving the selection of external service providers and agreeing terms of appointment.

Summary

47. Prior to the beginning of each financial year the council must approve the treasury management strategy. The strategy sets the parameters within which officers can invest the council's surplus fund.

48. This strategy provides a commentary on the current financial climate and sets out the council's lending strategy in response to this.

Economic conditions and interest rate forecasts

In order to put the investment strategy into context it is necessary to consider the external factors in the financial markets and their impact on interest rate forecasts.

Global economy – the outlook for the Eurozone (EZ) economy dominates the financial markets and this will remain so until fundamental issues over the structure of the currency in the EZ are resolved. Weak or negative growth will also continue to be a key factor as this determines how much income will be generated in relation to each counties debt repayments. This has affected the UK economy and is likely to affect growth in 2013. The recession is now the worst and slowest recovery of any of the five recessions since 1930.

UK economy – In August 2012 the Bank of England lowered its expectations for the speed of recovery and rate of growth. The growth in the UK economy remains weak and forecasts for growth have been reduced for the next two years. The governments austerity measures aimed at getting the public sector deficit under control in the next four years, now look as if they may not meet the original timeframe. Currently the UK is enjoying a major financial benefit from some of the lowest sovereign borrowing costs in the world, as the UK is seen as safe haven from Euro zone debt.

Economic growth – Economic growth has basically, flat lined since the election in 2010, and the economic forecasts for 2012 and beyond were revised substantially lower in the Bank of England Inflation quarterly report for August 2102. Quantitative Easing (QE) was increased again by £50bn in July 2102 to a total of £375bn.

Unemployment – The Government's austerity strategy has resulted in a substantial reduction in employment in the public sector. Despite this, total employment has increased to the highest level for four years (August 2012) and the number of unemployment benefit claimants has also been falling slightly.

Inflation and Bank rate – Inflation has fallen sharply during 2012 from a peak of 5.2% in September 2011 to 2.2% in September 2012. Inflation is expected to fall further to the 2% target level within the two year horizon.

AAA rating – the UK's sovereign rating was recently reaffirmed, but warnings to review the position have been made if the government were to change the deficit reduction programme, or if the desired outcome was not being achieved. The status has provided a safe haven for investors.

Sector's forward view

Economic forecasting remains difficult with so many influences affecting the UK. There does appear to be consensus among analysts that the economy remains fragile. Key areas of uncertainty include:

- The second Greek bailout package could cause greater problems in EZ debt and a higher risk of breakdown of the EZ or even the currency itself;

- The impact of the UK governments austerity plan on confidence and growth and the need to rebalance the economy from services to exporting manufactured goods;
- The economic performance of the UK's trading partners in particular the EU and US as some analysts suggest that recession may return to both;

The overall balance of risks remains weighted to the downside. Many consumers, corporates and banks are still focused on reducing their borrowings rather than spending so will continue to act as a major headwind to a return to robust growth.

Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to high volumes of gilt issuance in the UK, and the high volume of debt issuance in other major western countries.

Given the weak outlook for economic growth, Sector sees the prospects for any interest rate changes before the end of 2014 as very limited. There is potential for the start of the Bank Rate increases to be delayed further if growth disappoints.

The uncertain economic outlook has several key implications for treasury management:

- The sovereign debt issues provide a clear indication of higher counterparty risk.
- Investment returns are likely to remain low for 2013/14.
- Borrowing rates are historically very low and may remain low for some time.

Prospects for interest rates

The bank base rate is forecast to remain unchanged at 0.5%, rising in Q4 in 2014. Sector's central view for bank rate forecasts is shown below:

	Bank of England base rate	PWLB borrowing rates (adjusted for certainty rate)		
		5 yr	25 yr	50 yr
Dec 2012	0.50%	1.50%	3.70%	3.90%
Dec 2013	0.50%	1.60%	3.80%	4.00%
Dec 2014	0.75%	2.00%	4.10%	4.30%

There are downside risks to these forecasts for example if economic growth remains weaker for longer than expected. However, there is also an upside risk that the pace of growth in interest rates could pick up more quickly than expected if inflation exceeds the Bank of England's target rate of two per cent.

Forecast of long term PWLB rates to March 2016 as provided by Sector Treasury Services Ltd at 20 November 2012 are:

Sector's interest rate forecast

	Now	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15
Bank base rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%
3m LIBID	0.50%	0.50%	0.60%	0.50%	0.50%	0.50%	0.50%	0.60%	0.60%	0.70%	0.80%	1.10%
6m LIBID	0.70%	0.70%	0.70%	0.70%	0.70%	0.70%	0.70%	0.80%	0.90%	1.00%	1.10%	1.30%
12m LIBID	0.70%	1.00%	1.00%	1.00%	1.00%	1.00%	1.10%	1.10%	1.20%	1.30%	1.30%	1.50%
5 yr PWLB rate	1.60%	1.50%	1.50%	1.50%	1.60%	1.60%	1.70%	1.70%	1.80%	2.00%	2.20%	2.30%
10 yr PWLB rate	2.50%	2.50%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	3.00%	3.20%	3.30%
25 yr PWLB rate	3.80%	3.70%	3.80%	3.80%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.30%	4.40%
50yr PWLB rate	3.90%	3.90%	4.00%	4.00%	4.00%	4.00%	4.10%	4.10%	4.20%	4.30%	4.50%	4.60%

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

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

Yield. Benchmarks are used to assess the performance of investments. The local measures of yield are:

Table 6: investment benchmarks	
Investment category	Benchmark
Bank & building society deposits - non-managed	3 Month LIBID
Equities	FTSE all shares index
Property related investments	IPD balanced Property Unit Trust Index
Corporate bonds	BoE base rate

Security and liquidity benchmarks are intrinsic to the approved treasury strategy through the counterparty selection criteria and some of the prudential indicators.

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

- Bank overdraft – there is an agreed overdraft facility of up to £700,000.
- Liquid short term deposits of at least £10,000,000 available within a weeks' notice.

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

- WAL benchmark is expected to be 0.5 years, with a maximum of 3 years.

Security of the investments. In the context of benchmarking, assessing security is very much more a subjective area to assess. Security is currently evidenced by the application of minimum credit quality criteria to investment counterparties, primarily through the use of credit ratings supplied by the three main credit rating agencies (Fitch, Moody's and Standard and Poor's). Whilst this approach embodies security considerations, benchmarking levels of risk is more problematic. One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council's investment strategy. The table beneath shows average defaults for differing periods of investment grade products for each Fitch long term rating category over the period 1990 to 2011.

Average defaults for differing periods of investment

Long term rating	1 year	2 years	3 years	4 years	5 years
AAA	0.00%	0.02%	0.06%	0.09%	0.13%
AA	0.02%	0.04%	0.14%	0.28%	0.36%
A	0.09%	0.25%	0.43%	0.60%	0.79%
BBB	0.23%	0.65%	1.13%	1.70%	2.22%
BB	0.93%	2.47%	4.21%	5.81%	7.05%
B	3.31%	7.89%	12.14%	15.50%	17.73%
CCC	23.15%	32.88%	39.50%	42.58%	45.48%

The council's minimum long term rating criteria is currently "A" meaning the average expectation of default for a one year investment in a counterparty with an "A" long term rating would be 0.09% of the total investment (e.g. for a £1m investment the average loss would be £900). This is only an average - any specific counterparty loss could potentially be higher or lower. These figures act as a proxy benchmark for risk across the portfolio.

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

	1 year	2 years	3 years	4 years	5 years
Maximum	0.20%	0.30%	0.45%	0.60%	0.75%

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

Property Investment Policy

1.0 Direct investment in property

1.1 The council is restricted in the different investment vehicles it is legally allowed to invest in notwithstanding the over-riding need for prudence mentioned earlier. Of the options open one is property and the returns from investing in property can be greater than the opportunities in the money markets.

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

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

2.0 How much is invested?

2.1 £16 million is currently held in property and £124 million is invested in treasury investments. The investment in property represents 11% of the overall total.

3.0 What type of property?

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

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

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

4.0 Where should it be located?

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

Only property located in the UK will be considered.

5.0 What level of financial return?

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

6.0 Review

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

Explanation of Prudential Indicators

Central government control of borrowing was ended and replaced with Prudential borrowing by the Local Government Act 2003. Prudential borrowing permitted local government organisations to borrow to fund capital spending plans provided they could demonstrate their affordability. Prudential indicators are the means to demonstrate affordability.

Capital expenditure – shows last year's spending, this year's projected spending and the approved programme until 2014/15.

Ratio of financing costs to net revenue stream – because the council has no net debt investment interest on reserves and balances makes a positive contribution to the council's finances.

Net borrowing requirement – this demonstrates that no borrowing is planned to fund the capital programme.

In year capital financing requirement – this shows the council has no borrowing.

Capital financing requirement (CFR) as at 31 March – the CFR shows the underlying need of the council to borrow for capital purposes as determined from the balance sheet. The overall CFR is nil , there is no need to borrow.

Incremental impact of capital investment decisions – increase in Council Tax (band D) per annum – this indicator shows the affect of the latest capital programme report on annual council tax. This indicator is based on the estimated decrease or increase in interest payable to the General Fund each year due to the changed funding of the capital programme in the latest capital report to December 2011 cabinet.

Incremental impact of capital investment decisions – This indicator shows the affect of the latest capital programme report on revenue. This indicator is based on the estimated decrease or increase in interest payable to the funding of the capital programme. As the council has no debt this indicator is not relevant.

Authorised limit for external debt – this is the maximum limit for external borrowing. This is the statutory limit determined under section 3(1) of the Local Government Act 2003. This limit is set to allow sufficient headroom for day to day operational management of cash flows.

Operational boundary for external debt – this is set as the more likely amount that may be required for day to day cash flow. This has an amount included to allow for cash flow borrowing associated with the canal project.

Upper limit for fixed and variable interest rate exposure – these limits allow the council flexibility in its investment and borrowing options.

Upper limit for total principal sums invested for over 364 days – the amount it is considered can be prudently invested for periods in excess of a year.

Adoption of the CIFPA Code of Practice for Treasury Management

The council adopted this code on 25 April 2002 and the strategic director for finance confirms that the authority continues to comply with this.

This indicator in respect of treasury management confirms that the council has adopted the CIPFA code of practice for treasury management in public services. This is to provide assurance that treasury management activities are being carried out in line with best practice.

Treasury Management Practice (TMP) 1 – credit and counterparty risk management

The CLG issued Investment Guidance in 2010, and this forms the structure of the council's policy below.

The key aim of the guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This council adopted the code on 25 March 2002 and will apply its principles to all investment activity. In accordance with the code, the head of finance has produced its treasury management practices (TMPs). This part, TMP1(5), covering investment counterparty policy requires approval each year.

The key requirements of both the code and the guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of:

- the strategy guidelines for decision making on investments, particularly non-specified investments.
- the principles to be used to determine the maximum periods for which funds can be committed.

In compliance with the above guidance the Annual investment Strategy is now incorporated within the council's treasury management strategy and includes the following:

- specified investments: these are high security, i.e. having a high credit rating, (although this is defined by the council, and no guidelines are given), and high liquidity investments, in sterling with a maturity of no more than one year.

- non-specified investments: covers all other investments, which may have a maturity of greater than one year or lower security rating or both.

The Annual Investment Strategy within the treasury management strategy is approved by full council.

All limits in the investment strategy apply to both in-house and externally managed funds.

Specified Investments

These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the council has the right to be repaid within 12 months if it wishes. These are low risk assets where the possibility of loss of principal or investment income is negligible. These investments are categorised as:

a) UK Government (such as the Debt Management Office, UK Treasury Bills or gilts with less than one year to maturity)
b) Supranational bonds of less than one year's duration
c) A local authority, parish council or community council

d) An investment scheme that has been awarded a high credit rating by a credit rating agency
e) A body that has been awarded a high credit rating by a credit rating agency (such as a bank or building society)

Non-specified Investments

Non-specified investments are any other type of investment (i.e. not defined as specified). These investments are categorized as:

f) Supranational bonds greater than 1 year to maturity.
g) Gilt edged securities.
h) Building societies not meeting the basic security requirements under the specified investments.
i) Any bank or building society that has a minimum long term credit rating as shown in table 5, for deposits with a maturity of greater than one year.
j) Any non-rated subsidiary of a credit rated institution included in the specified investment category.
k) Share capital in a body corporate.
l) Corporate bonds
m) Housing Association investment
n) Property direct property investment
o) Pooled property fund investment

These categories of investment will vary in their levels of risk, and the return that may be expected from them. The identification and rationale supporting the selection investments and the maximum limits to be applied are set out in table 5.

Local Authority Mortgage Scheme (LAMS). This type of investment is classified as a service investment rather than a treasury management investment, it therefore fall outside of the scope of the investment categories above.

Cash deposits

1. The majority of the council's investments are held in cash deposits. These can be made with banks or building societies that meet the credit rating criteria detailed in annexe 1. Any non-rated subsidiary of a credit rated institution can be included as an investment category subject to individual assessment of the relationship between themselves and the parent bank. Where institutions are part of a banking group then the maximum lending criteria will be shared between the group companies. Limits on amounts for each counterparty are determined by credit rating and maturity period.

2. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies that are credit rated. The council may use such building societies which have a minimum asset size of £250 million, but will restrict these types of investments to six months.

3. Cash deposits can be made with UK local authorities up to a period of five years and a maximum of £15 million per authority. Local authorities do not require a credit rating, and are classed as a low risk counterparty due to their funding and income streams.

Gilts

4. Gilts (or 'gilt-edged stocks') are bonds issued by the UK government which pay a fixed rate of interest usually twice a year. They are considered safe investments as the government is unlikely to default on the interest payments. If held to maturity they will return their issue value; if sold before their redemption date the price realised will fluctuate with market conditions. Gilts are bought and sold on the stock market where their price can go up or down. The strategy permits investments of up to £15 million in gilts. The council does not currently hold any gilts, as market conditions have not presented an opportune time to enter the gilt market. This is reviewed frequently.

Government's debt management account deposit facility (DMADF)

5. The DMADF is a deposit account with the Government. The rates are very low, however this is offset by the increased security and facility to improve the portfolio's spread of investments. A maximum limit of 100 per cent of the portfolio is set in the strategy for this facility. The account is only used when it is not possible, or it is outside the council's risk tolerance to place monies elsewhere.

Money market funds (MMFs)

6. MMFs are commercially run, pooled investments. They work rather like unit trusts, but whereas the latter are based upon shares in companies, MMFs rely on loans to companies. As their pooled funds have a high total value better rates of returns can be obtained. Legislation allows authorities to access only those MMFs with the highest possible credit rating (AAA).

7. The maximum limit to be invested in this type of instrument is £20 million. Access and liquidity of these instruments are extremely flexible, as they operate on a similar basis to call deposit accounts in that the funds can be placed or withdrawn with a minimum amount of notice, but tend to achieve better rates than short-term cash deposits placed in the market over similar periods, particularly in a declining or flat interest rate environment.

Certificates of deposit

8. Certificates of deposit are a type of bonds issued by banks. They are classified as non- specified investments. Certificates of deposit are bought and sold on the stock market where their price can go up or down. If held to maturity they will return their issue value; if sold before their redemption date the price realised will fluctuate with market conditions. The council would only consider purchase of these investments to be held until maturity.

Corporate bonds

9. Corporate bonds are issued by companies as a way of raising money to invest in their business. They have 'par' or nominal value' (usually £100), which is the amount that will be returned to the investor on a stated future date (the 'redemption date'). They also pay a stated interest rate each year, usually fixed. Corporate bonds are bought and sold on the stock market and their price can go up or down.

10. The council continues to maintain holdings of corporate bonds previously acquired, on the basis that returns on these securities over their remaining lives should out perform the current bond markets and returns from fund management, given the view that

interest rates and yields are forecast to remain low in the near term. The strategy permits investments of up to £10 million in corporate bonds (measured at the time of purchase). The current value of corporate bonds held is £4.2 million as at 31 December 2012.

11. The remaining bonds are providing an excellent rate of return. As bond prices tend toward par as they approach maturity, there will be an optimum point at which each bond provides the best return versus the deterioration in capital value. Sector has reviewed the council's current holdings and the analysis shows that in the current interest rate environment they should be held until maturity. The review also explores the possibility of lengthening the maturity profile to maintain the higher rates of return. Given the current uncertainty and higher risk, it is not a recommended option at this time.

Property – direct investment

12. The council is able to purchase property as an investment, however this is a specialist area and it is necessary to seek external advice on how the council could best diversify its investments by the inclusion of property.

13. The council is reviewing further investment in property in conjunction with the council's property advisors, a report will be brought forward in the year ahead. The treasury management strategy allows for a further investment of up to £20 million in either direct property holdings (as measured at the time of purchase) or indirect property investments.

14. The council currently retain properties for investment purposes. As at the end of March 2012, the latest period for which audited figures are available, these had an aggregate book value of £16.3 million.

Property – indirect investment

15. The council is able to invest in pooled property investment funds. These are pooled investments where units are purchased. The fund invests in a cross section of property ie: commercial, industrial, retail and residential. This type of investment is highly liquid as units can be sold quickly if required. They are also exempt from capital accounting as disposal income does not have to be treated as a capital receipt. This can give greater flexibility in the use of future income. The disadvantage of this type of fund is that they have a high entry fee and annual management charges. The council is reviewing the investment in this type of product with the assistance of the council's treasury advisors (Sector) to assess which products may be suitable. The strategy provides for investment up to £10 million in a property related investment fund.

Bond funds

16. These are pooled investment funds which have been developed to provide investors with access to the bond market, spreading the risk of direct bond holdings by giving access to a portfolio of mixed bonds ranging from UK Gilts, supranational bonds, other government guaranteed issues and corporate bonds of both banks and corporate organisations. Very much like MMFs they are strictly regulated and those that achieve AAAf credit rating must maintain liquidity. Funds can be accessed quickly if required. The maximum limit to be invested in this type of instrument is £5 million.

Equities

17. 'Equity' is an investment in the share capital of a publicly quoted company. Equity is the risk-bearing part of the company's capital and contrasts with debt capital which is usually secured in some way, and which has priority over shareholders if the company becomes insolvent and its assets are distributed.

18. For most companies there are two types of equity: ordinary shares, which have voting rights, and preference shares, which do not. Owners of preference shares rank ahead of ordinary shareholders in a liquidation.

19. The council's investments in equities are liquid investments, which mean they could be sold at any time, from which an investment gain (or loss) could accrue to the council.

20. The council continues to maintain its current equity holdings, on the basis that that although the returns have fluctuated these are intended to be held long-term and they also provide diversity to the portfolio. The strategy permits investments of up to £10 million in equities (measured at the time of purchase).

21. As these investments fluctuate significantly over short periods of time, they are kept under constant review. When the current holdings reach £14 million, a further £2 million will be disposed of.

Supranational bonds

22. Supranational bonds fall into two main categories – multilateral development bank bonds, or those offered by a financial institution that is guaranteed by the UK Government. The security of interest and principal on maturity is on a par with UK Government bonds and these bonds usually provide returns above equivalent gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity. The treasury management strategy permits investment of up to £15 million in supranational bonds (measured at the time of purchase). The council currently does not hold these investments, although they offer excellent security and liquidity. This is reviewed periodically. Given the current low yields it would not be the best time to purchase these to hold for the long term.

Credit and counterparty risk management

The council regards the prime objective of its treasury management activities to secure the principle sums invested, whilst maximising of investment returns, within a level of risk that is acceptable to the council. It will ensure that its counterparties and limits, reflect a prudent attitude towards organisations with whom funds may be deposited, and will limit its investment activities to the instruments listed below. It also recognises the need to have, and will therefore maintain, a formal counterparty policy in respect of those organisations from which it may borrow, or with whom it may enter into other financing arrangements.

The following counterparties and limits will apply in aggregate to both internally and externally managed funds, as measured at the time of investment:

- *Banks and building society deposits – cash and certificates of deposits.*

  A maximum sum of £15 million can be lent to any one individual bank or building society providing it meets the minimum credit rating criteria set out in the investment strategy.

- *Banks – part nationalised*

  A maximum sum of £20 million can be lent to any one individual bank that is part nationalised.

- *UK government or local authorities*

  A maximum sum of £15 million could be lent to a local authority or UK Government.

- *Supranational bonds*

  The maximum sum that can be invested in supranational bonds is £15 million.

- *Gilt edged securities*

  The maximum investment, excluding investment returns, to be invested in Gilt Edged Securities is £15 million.

- *Corporate bonds*

  The maximum sum that can be invested in United Kingdom Corporate Bonds is £10 million.

- *Equities*

  The maximum sum, excluding investment returns that can be invested in United Kingdom equities is £10 million, but only through the purchase of units of Index Tracking Trusts. As approved by council, the investment returns from the equities are re-invested in this investment instrument.

- *Money Market Funds (MMF)*

  The maximum sum to be invested in MMFs is £20 million. Government legislation restricts authority's access only to those MMFs with the highest possible credit rating (AAA).

- *Bond Funds*

  The maximum to be invested in a pooled bond fund is £5m and only those that have a AAAf rating should be considered.

- *The government's debt management account deposit facility (DMCDF)*

  The maximum sum to be invested in the government's DMA Deposit Facility is 100 per cent of the total investment portfolio.

- *Pooled Property funds*

  The maximum amount to be invested in property related funds is £10 million. This would be subject to receipt of specialist advice from the council's strategic property advisors and treasury advisors and would be the subject of a separate report to cabinet/council.

- *Property- direct investment*

  The maximum amount to be invested directly in property is £30 million. This would be subject to receipt of specialist advice from the council's strategic property advisors and would be the subject of a separate report to cabinet/council.

Investment spread

As a guideline, it is recommended that the council's investment in any one of the council's approved investment instruments should not exceed the maximum percentage / monetary limits listed below:

Cash and certificates of deposit	85%
Local authorities	50%
Debt management account deposit facility	100%
Supranational bonds	£10m
Gilts	£15m
Equities	£10m
Corporate bonds	£10m
Money market funds	£20m
Pooled Bond Fund	£ 5m
Property - direct investments	£30m
Housing association	£15m
Property pooled fund	£10m
External fund manager	£15m

GLOSSARY OF TERMS

Basis Point (BP)	1/100th of 1%, i.e. 0.01%
Base Rate	Minimum lending rate of a bank or financial institution in the UK.
Benchmark	A measure against which the investment policy or performance of a fund manager can be compared.
Bill of Exchange	A financial instrument financing trade.
Callable Deposit	A deposit placed with a bank or building society at a set rate for a set amount of time. However, the borrower has the right to repay the funds on pre agreed dates, before maturity. This decision is based on how market rates have moved since the deal was agreed. If rates have fallen the likelihood of the deposit being repaid rises, as cheaper money can be found by the borrower.
Cash Fund Management	Fund management is the management of an investment portfolio of cash on behalf of a private client or an institution, the receipts and distribution of dividends and interest, and all other administrative work in connection with the portfolio.
Certificate of Deposit (CD)	Evidence of a deposit with a specified bank or building society repayable on a fixed date. They are negotiable instruments and have a secondary market; therefore the holder of a CD is able to sell it to a third party before the maturity of the CD.
Commercial Paper	Short-term obligations with maturities ranging from 2 to 270 days issued by banks, corporations and other borrowers. Such instruments are unsecured and usually discounted, although some may be interest bearing.
Corporate Bond	Strictly speaking, corporate bonds are those issued by companies. However, the term is used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies.
Counterparty	Another (or the other) party to an agreement or other market contract (e.g. lender/borrower/writer of a swap/etc.)
CDS	Credit Default Swap – a swap designed to transfer the credit exposure of fixed income products between parties. The buyer of a credit swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the product. By doing this, the risk of default is transferred from the holder of the fixed income security to the seller of the swap.
CFR	Capital Financing Requirement.
CIPFA	Chartered Institute of Public Finance and Accountancy.
CLG	Department for Communities and Local Government.

Derivative	A contract whose value is based on the performance of an underlying financial asset, index or other investment, e.g. an option is a derivative because its value changes in relation to the performance of an underlying stock.
DMADF	Deposit Account offered by the Debt Management Office, guaranteed by the UK government.
ECB	European Central Bank – sets the central interest rates in the EMU area. The ECB determines the targets itself for its interest rate setting policy; this is the keep inflation within a band of 0 to 2%. It does not accept that monetary policy is to be used to manage fluctuations in unemployment and growth caused by the business cycle.
Equity	A share in a company with limited liability. It generally enables the holder to share in the profitability of the company through dividend payments and capital gain.
Forward Deal	The act of agreeing today to deposit funds with an institution for an agreed time limit, on an agreed future date, at an agreed rate.
Forward Deposits	Same as forward dealing (above).
Fiscal Policy	The government policy on taxation and welfare payments.
GDP	Gross Domestic Product.
Gilt	Registered british government securities giving the investor an absolute commitment from the government to honour the debt that those securities represent.
Money Market Fund	A well rated, highly diversified pooled investment vehicle whose assets mainly comprise of short-term instruments. It is very similar to a unit trust, however in a MMF.
Monetary Policy Committee (MPC)	Government body that sets the bank rate (commonly referred to as being base rate). Their primary target is to keep inflation within plus or minus 1% of a central target of 2.5% in two years time from the date of the monthly meeting of the committee. Their secondary target is to support the government in maintaining high and stable levels of growth and employment.
Other Bond Funds	Pooled funds investing in a wide range of bonds.
PWLB	Public Works Loan Board.
QE	Quantitative Easing.
Retail Price Index	Measurement of the monthly change in the average level of prices at the retail level weighted by the average expenditure pattern of the average person.

Sovereign Issues (Ex UK Gilts)	Bonds issued or guaranteed by nation states, but excluding UK government bonds.
Supranational Bonds	Bonds issued by supranational bodies, e.g. European Investment Bank. The bonds – also known as Multilateral Development Bank bonds – are generally AAA rated and behave similarly to gilts, but pay a higher yield ("spread") given their relative illiquidity when compared with gilts.
Treasury Bill	Treasury bills are short-term debt instruments issued by the UK or other governments. They provide a return to the investor by virtue of being issued at a discount to their final redemption value.

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