COUNCIL - 21 FEBRUARY 2012

TREASURY MANAGEMENT STRATEGY 2012/13

Report of the:	Deputy Chief Executive and Director of Corporate Resources
Also considered by:	Performance and Governance Committee – 10 January 2012 Finance Advisory Group - 25 January 2012 Cabinet - 9 February 2012
Status:	For decision
Key Decision:	No

Executive Summary: The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the 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.

The Act therefore 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.

The Chartered Institute of Public Finance and Accountancy (CIPFA) revised the Prudential Code, Treasury Management Code and Guidance Notes in November 2011 and recommend formal adoption of the amended clauses and a restatement of the Treasury Management Policy Statement. These have been included in the main body of the report.

Members' particular attention is drawn to paragraphs 43-59 of the report, which deal with changes to the investment criteria in the light of recent credit rating downgrades.

This report has been considered by the Performance and Governance Committee and the Finance Advisory Group (paragraphs 70 to 72) and they considered that, given the limited number of institutions to which the Council could lend, should reduce the minimum long term credit rating in the 2012/13 creditworthiness policy to A. This view was agreed by Cabinet on 9 February 2012.

This report supports the Key Aim of effective management of Council resources.

Portfolio Holder	Cllr. Ramsay
Head of Service	Head of Finance and Human Resources – Mrs. Tricia Marshall

Recommendations:

That Council approve the Treasury Management Strategy Statement set out in this report with the exception that the minimum long term credit rating in the 2012/13 creditworthiness policy be reduced to A.

Background

1. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

2. The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

3. CIPFA defines treasury management as:

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

Introduction

Reporting requirements

4. The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals. These reports are required to be adequately scrutinised by committee before being recommended to the Council. This role is undertaken by the Finance Advisory Group and the Performance and Governance Committee.

5. Prudential and Treasury Indicators and Treasury Strategy (This report) - The first, and most important report covers:

   - the capital plans (including prudential indicators);

   - a Minimum Revenue Provision Policy (MRP) (how residual capital expenditure is charged to revenue over time);

- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

6. A Mid Year Treasury Management Report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision.

7. An Annual Treasury Report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

<u>Treasury Management Strategy for 2012/13</u>

8. The strategy for 2012/13 covers two main areas:

Capital Issues

- the capital plans and the prudential indicators;
- the MRP strategy.

Treasury management Issues

- the current treasury position;
- treasury indicators which will limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

9. These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the CLG MRP Guidance, the CIPFA Treasury Management Code and the CLG Investment Guidance.

10. The suggested strategy for 2012/13 in respect of the above 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 Limited.

Capital Issues

The Capital Prudential Indicators 2012/13 – 2014/15

11. The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members overview and confirm capital expenditure plans.

Capital Expenditure

12. This prudential Indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

	2010/11 Actual £000	**2011/12 Estimate £000**	**2012/13 Estimate £000**	**2013/14 Estimate £000**	**2014/15 Estimate £000**
Capital Expenditure	2,786	2,629	1,423	1,323	1,423

13. Other long term liabilities. The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.

14. The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing).

	2010/11 Actual £000	2011/12 Estimate £000	2012/13 Estimate £000	2013/14 Estimate £000	2014/15 Estimate £000
Capital Expenditure	2,786	2,629	1,423	1,323	1,423
Financed by:					
Capital receipts	139	343	197	-	-
Capital grants	1,669	690	396	396	396
Capital reserves	456	330	330	327	327
Revenue	522	1,266	500	600	700
Net financing need for the year	**2,786**	**2,629**	1,423	1,323	1,423

The Council's Borrowing Need (the Capital Financing Requirement)

15. The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

16. Following accounting changes the CFR includes any other long term liabilities (e.g. finance leases) brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £0.2m of such schemes within the CFR.

17. The Council is asked to approve the CFR projections below:

	2010/11 Actual £000	2011/12 Estimate £000	2012/13 Estimate £000	2013/14 Estimate £000	2014/15 Estimate £000
Capital Financing Requirement					
Total CFR	206	185	164	143	122
Movement in CFR	-21	-21	-21	-21	-21

Movement in CFR represented by:					
Net financing need for the year (above)					
Less MRP/VRP and other financing movements	-21	-21	-21	-21	-21
Movement in CFR	**-21**	**-21**	**-21**	**-21**	**-21**

Note:- The MRP / VRP includes finance lease annual principal payments

MRP Policy Statement

18. The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

19. CLG Regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:

20. For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be based on CFR – MRP will be based on the CFR.

21. These options provide for an approximate 4% reduction in the borrowing need (CFR) each year.

22. From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be the Depreciation method – MRP will follow standard depreciation accounting procedures. This provides for a reduction in the borrowing need over approximately the asset's life. Repayments included in annual PFI or finance leases are applied as MRP.

The Use of the Council's Resources and the Investment Position

23. The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources	**2010/11 Actual £000**	**2011/12 Estimate £000**	**2012/13 Estimate £000**	**2013/14 Estimate £000**	**2014/15 Estimate £000**
Fund balances / reserves	17,711	19,684	20,437	19,624	17,828
Capital receipts	763	461	1,317	2,668	2,725
Provisions	2,719	152	152	152	152
Other	-	-	-	-	-
Total core funds	**21,193**	20,297	21,906	22,444	20,705
Working capital*	21,193	20,297	21,906	22,444	20,705
Under/over borrowing	0	0	0	0	0
Expected investments	**21,193**	**20,297**	**21,906**	**22,444**	**20,705**

*Working capital balances shown are estimated year end; these may be higher mid year

Estimates of the incremental impact of capital investment decisions on council tax.

24. This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Council tax band D	£-0.14	£0.93	£0.41	£0.31	£0.41

Treasury Management Issues

25. The capital expenditure plans set out above provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

Current Portfolio Position

26. The Council's treasury portfolio position at 24 January 2012 appears in Appendix A.

Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary

27. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational boundary	**2011/12 Estimate £000**	**2012/13 Estimate £000**	**2013/14 Estimate £000**	**2014/15 Estimate £000**
Debt	5,000	5,000	5,000	5,000
Other long term liabilities	0	0	0	0
Total	**5,000**	**5,000**	**5,000**	**5,000**

The Authorised Limit for external debt

28. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

29. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

30. The Council is asked to approve the following Authorised Limit:

Authorised limit	**2011/12 Estimate £000**	**2012/13 Estimate £000**	**2013/14 Estimate £000**	**2014/15 Estimate £000**
Debt	5,000	5,000	5,000	5,000
Other long term liabilities	0	0	0	0
Total	**5,000**	**5,000**	**5,000**	**5,000**

Prospects for Interest Rates

31. The Council has appointed Sector Treasury Services Limited as its treasury advisor 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 City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Sector central view.

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

32. Growth in the UK economy is expected to be weak in the next two years and there is a risk of a technical recession (i.e. two quarters of negative growth). Bank Rate, currently 0.5%, underpins investment returns and is not expected to start increasing until quarter 3 of 2013 despite inflation currently being well above the Bank of England's Monetary Policy Committee inflation target. Hopes for an export led recovery appear likely to be disappointed due to the Eurozone sovereign debt crisis depressing growth in the UK's biggest export market. The Comprehensive Spending Review, which seeks to reduce the UK's annual fiscal deficit, will also depress growth during the next few years.

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

34. This challenging and uncertain economic outlook has a several key treasury mangement implications:

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

Borrowing Strategy

35. It is anticipated that there will be no capital borrowings required during 2012/13.

Annual Investment Strategy

<u>Investment Policy</u>

36. The Council's investment policy has regard to the Department of Communities and Local Government (CLG) Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.

37. In accordance with the above, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings and watches published by all three ratings agencies with a full understanding of what the ratings reflect in the eyes of each agengy. Using the Sector ratings service banks' ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

38. Further, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to contiunally assess and monitor the financial sector on both a micro and macro basis and

in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as “Credit Default Swaps (CDS)” and overlay that information on top of the credit ratings. This is encapsulated within the credit methodology provided by the advisors, Sector.

39. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

40. The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable divesification and thus avoidance of concentration risk.

41. The intention of the strategy is to provide security of investment and minimisation of risk.

42. Investment instruments identified for use in the financial year are listed in Appendix C under the ‘Specified’ and ‘Non-Specified’ Investments categories. Counterparty limits will be as set through the Council’s Treasury Management Practices – Schedules.

Creditworthiness Policy

43. This Council applies the creditworthiness service provided by Sector. This service employs a sophisticated modelling approach utlilising credit ratings from the three main credit rating agencies - Fitch, Moodys and Standard and Poors. The credit ratings of counterparties are supplemented with the following overlays:

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

44. This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the duration for investments. The Council will therefore use counterparties within the following durational bands:

- 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

45. This methodology does not apply the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties. The Sector creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

46. Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of Short Term rating F1, Long Term rating A-, Individual of Viability ratings of C- (or BB+), and a Support rating of 3. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

47. All credit ratings will be monitored regularly. The Council is alerted 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 Council's lending list.

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

<u>Country limits</u>

49. The Council has determined that it will only use approved counterparties from the UK or the EU which also have a minimum sovereign credit rating of AA- from Fitch. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix D. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

<u>Investment Counterparty Selection Criteria</u>

50. The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Council will ensure that:

It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investments listed in Appendix C; and

It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

51. Officers will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either Specified or Non-Specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

52. Credit rating information is supplied by Sector, our treasury consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (lending) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing.

53. The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) is:

- Banks 1 - good credit quality - the Council will only use banks which:

  are UK banks; and/or

  are EU banks and domiciled in a country which has a minimum sovereign long term rating of AA-

  and have, as a minimum, the following Fitch credit ratings:

  Short term F1

  Long term A-

  Viability / financial strength C-

  Support 3

- Banks 2 – Part nationalised UK banks – Lloyds Bank and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
- Banks 3 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- Building societies - The Council will use all societies which meet the ratings for banks outlined above
- Money Market Funds

- UK Government (including gilts, treasury bills and the DMADF)
- Other local authorities
- Supranational institutions

54. It should be noted that the previous minimum long term credit rating of AA- has been reduced to A- in the suggested 2012/13 creditworthiness policy, as recent downgrades have resulted in very few institutions meeting the previous minimum.

55. As an alternative to the construction of a counterparty (or lending) list based around the colour coded credit rating matrix supplied by Sector, Members may prefer an approach using certain specified institutions only. Such an approach might be to limit investments to the main UK banks and building societies irrespective of their credit ratings. The current long term ratings of the major UK banks and top building societies are as follows:

Barclays Bank plc A

Clydesdale Bank plc A+

Co-Operative Bank plc A-

Coventry Building Society A

HSBC Bank plc AA

Leeds Building Society A-

Lloyds Banking Group plc A

Nationwide Building Society A+

Royal Bank of Scotland Group plc A

Santander UK plc A+

56. The drawback of using a prescriptive list of nominated institutions is that it will not be sensitive to changes in ratings and will require further resolutions from Council to add institutions back on to the approved list.

57. Members views on this issue would be appreciated.

<u>Use of additional information other than credit ratings</u>

58. Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

Other Creditworthiness Issues

59. The Council's investment policy further limits the one proposed by Sector as follows:-

- Maximum investment period of 1 year.
- Investments are limited to 25% of the total fund to any single institution or institutions within a group of companies.
- Total investments in any one foreign country is limited to 15% of the total fund.
- Investments are limited to £5m per counterparty excluding call accounts and £6m including call accounts.

Investment Strategy

60. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

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

- 2011/ 2012 0.50%
- 2012/ 2013 0.50%
- 2013/ 2014 1.25%
- 2014/ 2015 2.50%

62. There are downside risks 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.

63. The suggested budgeted investment earnings rates for returns on investments placed for periods up to three months during each financial year for the next five years are as follows:

2012/13	0.70%
2013/14	1.00%
2014/15	1.60%
2015/16	3.30%
2016/17	4.10%

Icelandic Bank Investments

64. The Icelandic courts have supported the view that the Council will be treated as a preferred creditor, thereby seeing a high proportion of the investment being returned. The actual repayment is currently expected to be partially in foreign currency assets. It is currently too early to provide a definitive policy on how this exchange rate risk will be managed, but the expectation will be that the risk will be managed proactively and assets converted to sterling at the earliest opportunity.

Policy on the use of external service providers

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

66. 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.

67. 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

68. The guidance notes accompanying the revised Code also require that a statement of the Council's scheme of delegation in relation to treasury management is produced as part of the Annual Investment Strategy. This appears at Appendix E.

Role of the Section 151 officer

69. As with the scheme of delegation mentioned in the previous paragraph, a statement of the role of the Section 151 officer is also required. This appears at Appendix F.

Consideration by Performance and Governance Committee on 10 January 2012

70. At its meeting on 10 January the Performance and Governance Committee considered this report and examined the issues around the Council's lending list and financial limits.

71. At the last meeting Members considered an Investment Strategy update which highlighted issues concerning credit ratings. Since the last meeting, only one bank met the current criteria. The report proposed reducing the current criteria of AA- to A-, or using a prescriptive list. Members were in general agreement that a prescriptive list would be too limited. It was acknowledged that there needed to be a balance between minimising the risk as much as possible whilst having the flexibility to be able to achieve a more favourable rate of

return. Some Members felt that this could still be achieved by only lowering the current criteria to an A rating.

Consideration by Finance Advisory Group on 25 January 2012

72. At its meeting on 25 January the Finance Advisory Group agreed with the Performance and Governance Committee and recommended that the Council should reduce the minimum long term credit rating in the 2012/13 creditworthiness policy to A instead of A-. The report had not mentioned that there were many institutions at A- and therefore it was felt putting it at A would not harm the diversity of the Council's portfolio.

Key Implications

Financial

73. The management of the Council's investment portfolio and cash-flow generated balances plays an important part in the financial planning of the authority. The security of its capital and liquidity of its investments is of paramount importance.

74. There are financial implications arising from the restriction of the Council's lending list in that an inferior rate of interest may have to be accepted on a particular investment if some of the smaller and lower-rated institutions have been removed from the list.

Community Impact and Outcomes

75. There are no community impacts arising from this report.

Legal, Human Rights etc.

76. This report satisfies the requirements of the Local Government Act 2003 and supporting regulations plus the Council's Financial Procedure Rules which both require the preparation of an annual treasury strategy.

Conclusions

77. The effect of the proposals set out in this report is to allow the Council to effectively and efficiently manage cash balances.

78. In line with the revised CIPFA Code of Practice on Treasury Management, the Annual Treasury Strategy must be considered by Council and this is planned for its meeting on 21 February 2012. Given the current uncertainties in the banking sector and financial markets, the Council may need to consider amending its strategy during the year.

Risk Assessment Statement

79. Treasury Management has two main risks :

Fluctuations in interest rates can result in a reduction in income from investments; and

A counterparty to which the Council has lent money fails to repay the loan at the required time.

80. The movement towards having a restricted lending list of better quality institutions but higher individual limits with those institutions reduces the chances of a default. But if a default did occur, the potential loss would be greater. Previously, the preference was to have smaller investments with a greater range of institutions.

81. These risks are mitigated by the annual investment strategy which has been prepared on the basis of achieving the optimum return on investments commensurate with proper levels of security and liquidity. However, Members should recognise that in the current economic climate, these remain significant risks and that the strategy needs to be constantly monitored.

Sources of Information: Existing treasury counterparty list

Treasury Management Strategy Statement for 2012/13 provided by Sector Treasury Services Ltd.

CIPFA – Prudential Code on Treasury Management

ODPM (now DCLG) – Guidance on Local Government Investments (March 2004)

CIPFA Treasury Management in the Public Services Code of Practice (Revised 2009,2010 & 2011)

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