Appendix B

Treasury Management Strategy 2011/12 – 2013/14

1.0 Introduction

1.1 The treasury management service is an important part of the overall financial management of the Council's affairs. The prudential indicators in Appendix A consider the affordability and impact of capital expenditure decisions, and set out the Council's overall capital framework. The treasury service considers the effective funding of these decisions. Together they form part of the process which ensures the Council meets its balanced budget requirement under the Local Government Finance Act 1992.

1.2 The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management). This Council adopted the Code of Practice on Treasury Management on 20 February 2003.

1.3 As a result of adopting the Code the Council also adopted a Treasury Management Policy Statement at the Policy, Finance and Administration Committee on 29 January 2003. This adoption is the requirements of one of the prudential indicators. The revised Code of Practice has revised the Treasury Management Policy Statement to include provision for the scrutiny of the Treasury Management Strategy and this Council has allocated this to the Budget and Strategic Planning Working Group and the Council's constitution has been amended accordingly.

1.4 The Treasury Management Policy requires an annual strategy to be reported to Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. A further treasury report is produced after the year-end to report on actual activity for the year, and a new requirement of the revision of the Code of Practice is that there is a mid-year monitoring report.

1.5 This strategy covers:

- The Council's debt and investment projections;
- The Council's estimates and limits on future debt levels;
- The expected movement in interest rates;
- The Council's borrowing and investment strategies;
- Treasury performance indicators;
- Specific limits on treasury activities;

2.0 Debt and Investment Projections 2011/12 – 2013/14

2.1 The borrowing requirement comprises the expected movement in the CFR and any maturing debt which will need to be re-financed. The table below shows this effect on the treasury position over the next three years. The expected maximum debt position during each year represents the Operational Boundary prudential indicator, and so may be different from the year end position. The table also highlights the expected change in investment balances.

	2010/11 Revised £000	2011/12 Estimate £000	2012/13 Estimate £000	2013/14 Estimate £000
External Debt				
Debt at 1 April	8,588	9,511	9,511	9,511
Expected change in debt	923	0	0	0
Debt at 31 March	9,511	9,511	9,511	9,511
Operational Boundary	**11,732**	**11,700**	**11,200**	**11,200**
Investments				
Total Investments at 31 March	859	638	520	420
Investment change	-141	-221	-118	-100

2.2 The related impact of the above movements on the revenue budget are:

	2010/11 Revised £000	2011/12 Estimate £000	2012/13 Estimate £000	2013/14 Estimate £000
Revenue Budgets				
Interest on Borrowing	343	365	405	425
Related HRA Charge	-150	-160	-165	-165
Net General Fund Borrowing Cost	193	205	240	260
Investment income	12	11	9	12

3.0 **Limits to Borrowing Activity**

3.1 Within the prudential indicators there are a number of key indicators to ensure the Council operates its activities within well defined limits

3.2 For the first of these the Council needs to ensure that its total borrowing net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2011/12 and the following two financial years (the relevant comparative figures are highlighted). This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

	2010/11 Revised £000	2011/12 Estimate £000	2012/13 Estimate £000	2013/14 Estimate £000
External Loans	9,511	9,511	9,511	9,511
Plus Other long term liabilities	221	189	189	189
Gross Borrowing	9,732	9,700	9,700	9,700
Less Investments	-859	-638	-520	-420
Net Borrowing	8,873	9,062	9,180	9,280
CFR	**9,942**	**9,688**	**9,448**	**9,229**

3.3 The Head of Central Services reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.4 The Authorised Limit for External Debt – A further key prudential indicator represents a control on the overall level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by 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.

3.5 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 no control has yet been exercised.

3.6 The Council is asked to approve the following Authorised Limit:

Authorised limit	**2010/11 Revised £000**	**2011/12 Estimate £000**	**2012/13 Estimate £000**	**2013/14 Estimate £000**
Borrowing	18,780	18,810	18,310	18,310
Other long term liabilities	220	190	190	190
Total	19,000	19,000	18,500	18,500

3.7 Borrowing in advance of need – The Council has some flexibility to borrow funds this year for use in future years. The Head of Central Services may do this under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. Whilst the Head of Central Services will adopt a cautious approach to any such borrowing, where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities. Borrowing in advance will be made within the constraints that:

- It will be limited to no more than 100% of the expected increase in borrowing need (CFR) over the three year planning period; and
- Would not look to borrow more than 24 months in advance of need.

3.8 Risks associated with any advance borrowing activity will be subject to appraisal in advance and subsequent reporting through the mid-year or annual reporting mechanism.

4.0 **Expected Movement in Interest Rates**

Medium-Term Rate Estimates (averages)

Annual Average %	**Bank Rate**	**Money Rates**		**PWLB Rates***		
	%	**3 month %**	**1 year %**	**5 year %**	**25 year %**	**50 year %**
2010/11	0.5	0.7	1.5	2.6	4.6	4.7
2011/12	0.7	0.9	1.8	3.5	5.3	5.3
2012/13	1.7	1.9	2.8	4.0	5.4	5.4
2013/14	3.1	3.3	3.8	4.8	5.6	5.6
2014/15	4.0	4.2	4.5	5.6	5.6	5.8
2015/16	4.0	4.2	4.2	5.3	5.5	5.5

* Borrowing Rates

4.1 The Council's treasury management advisers have provided the following view of the economy for the forthcoming financial year:

a) Short-term rates are expected to remain on hold for a considerable time. The recovery in the economy has commenced and recent growth data has come in at the high side of expectations. Nevertheless, this higher rate is unlikely to be sustained, with growth expected to revert back to more insipid levels. The danger of a double-dip recession is fading but the crisis in the euro-zone, the prospects of tight economic policies at home and tenuous consumer confidence means the threat has still not evaporated completely.

b) The Office for Budget Responsibility has presented a realistically downbeat view of the economy's recovery prospects over the short and medium term, projecting that growth will struggle to exceed its trend rate in the current parliament. The Government's determination to cut the size of the public sector deficit considerably more quickly than its predecessor will be a drag upon activity in the medium term.

c) The void left by significant cuts in public spending will have to be filled by a number of alternatives – corporate investment, rising exports and consumers' expenditure. In terms of sheer magnitude, the latter is the most important and a strong recovery in this area is by no means certain. The combination of the desire to reduce the level of personal debt and continued job uncertainty is likely to weigh heavily upon spending. This will be amplified by fiscal policy tightening, outlined in the Budget and expanded upon in the 20 October Comprehensive Spending Review. Without a rebound in personal spending, any recovery in the economy is set to be weak and protracted.

d) The Bank of England admits that inflation will remain above target until 2012. Inflation performance remains a key risk to the future course of interest rates. Nevertheless, the perceived need to counter the fiscal squeeze via accommodative monetary policy suggests that barring a deterioration from the current situation, the MPC will be prepared to hold rates at very low levels until the latter stages of 2011.

e) The outlook for long-term interest rates is favourable in the near term but is set to deteriorate in the latter part of 2011. Yields will be suppressed by continued investor demand for safe haven instruments following the uncertainties and unfolding tensions within the entire Eurozone. In addition to this, the market has been underpinned by evidence of decelerating activity in major economies and the coalition government's apparent determination to deal with the parlous state of public sector finances. These two factors will restrict any deterioration in gilt market performance in the near term.

f) However, while the UK's fiscal burden will almost certainly ease, it will be a lengthy process and deficits over the next two to three financial years will still require a very heavy programme of gilt issuance. The latest Bank Inflation Report suggests the market will not be able to rely upon Quantitative Easing indefinitely to alleviate this enormous burden.

g) Eventually, the absence of the Bank of England as the largest buyer of gilts will shift the balance between supply and demand in the gilt-edged market. Other investors will almost certainly require some incentive to continue buying government paper.

h) This incentive will take the form of higher yields. The longer end of the curve will suffer from the lack of support from the major savings institutions – pension funds and insurance companies - who will continue to favour other investment instruments as a source of value and performance.

i) The front end of the curve will benefit from heavy purchases by banks as they seek to meet the FSA's proposed liquidity requirements. This will be a major benefit to the Government's gilt funding operations in the near term and will ensure the steeply-positive incline of the yield curve remains intact.

5.0 **Borrowing Strategy 2011/12 – 2013/14**

5.1 The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy.

5.2 Long-term fixed interest rates are at risk of being higher over the medium term, and short term rates are expected to rise, although more modestly. The Head of Central Services, under delegated powers, will 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. It is likely that shorter term fixed rates may provide lower cost opportunities in the short/medium term although any increase in the interest rate on variable rate loans is expected to be limited over the next three years and costs should remain cheaper than long term rates.

5.3 With the likelihood of long term rates increasing, debt restructuring is likely to focus on switching from longer term fixed rates to cheaper shorter term debt, although the Head of Central Services and treasury consultants will monitor prevailing rates for any opportunities during the year.

5.4 Following the Comprehensive Spending Review the PWLB increased borrowing interest rates by approximately 1%, without changing debt redemption interest rates. This will make PWLB debt rescheduling more problematic in the future.

5.5 The option of postponing borrowing and running down investment balances will continue to be considered. This would reduce counterparty risk and hedge against the expected fall in investments returns.

6.0 Investment Strategy 2011/12 – 2013/14

6.1 **Key Objectives -** The Council's investment strategy primary objectives are safeguarding the repayment of the principal and interest of its investments on time, then ensuring adequate liquidity, with the investment return being the final objective. Following the economic background above, the current investment climate has one over-riding risk, counterparty security risk. As a result of these underlying concerns officers are implementing an operational investment strategy which tightens the controls already in place in the approved investment strategy.

6.2 **Risk Benchmarking** – A development in the revised Codes and the CLG Investment Guidance is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are new requirements to the Member reporting, although the application of these is more subjective in nature. Additional background in the approach taken is attached at Annex B2.

6.3 These benchmarks are simple guides to maximum risk and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

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

- 0.08% historic risk of default when compared to the whole portfolio.

6.5 Liquidity – In respect of this area the Council seeks to maintain:

- Bank overdraft –up to £1m
- Liquid short term deposits of at least £0.25m available with a week's notice.
- Weighted Average Life benchmark is expected to be 1.5 years, with a maximum of 3 years.

6.6 Yield - Local measures of yield benchmarks are:

- Investments – to achieve a return on external investments above the 7 day rate

6.7 And in addition that the security benchmark for each individual year is:

	1 year	**2 years**	**3 years**	**4 years**	**5 years**
Maximum	0.06%	0.06%	0.08%	N/A	N/A

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

7.0 **Investment Counterparty Selection Criteria**

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

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections below.
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

7.2 The Head of Central Services will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. This criteria is separate to that which chooses Specified and Non-Specified investments as it provides an overall pool of counterparties considered high quality the Council may use rather than defining what its investments are.

7.3 The rating criteria use the **lowest common denominator** method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria. This is in compliance with a CIPFA Treasury Management Panel recommendation in March 2009 and the CIPFA Treasury Management Code of Practice.

7.4 Credit rating information is supplied by our treasury consultants on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance a negative rating watch applying to a counterparty at the minimum Council criteria will be suspended from use.

7.5 The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) is:

- **Banks 1 - Good Credit Quality** – the Council will only use banks which:
  i. Are UK banks; and/or
  ii. Are non-UK and domiciled in a country which has a minimum Sovereign long term rating of AA+ for Fitch and Standard & Poors and Aa1 for Moody's

And have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):

  i. **Short Term** – F1, P-1, A-1
  ii. **Long Term** – A-, A3, A-
  iii. **Individual / Financial Strength** – C (Fitch / Moody's only)
  iv. **Support** – 3 (Fitch only)

and using the lowest common denominator method of selecting counterparties.

- **Banks 2 – Guaranteed Banks with suitable Sovereign Support** – In addition, the Council will use banks whose ratings fall below the criteria specified above if all of the following conditions are met:
  - (a) wholesale deposits in the bank are covered by a government guarantee;
  - (b) the government providing the guarantee is rated "AAA" by all three major rating agencies (Fitch, Moody's and Standard & Poors); and
  - (c) the Council's investments with the bank are limited to amounts and maturities within the terms of the stipulated guarantee.
- **Banks 3 – Eligible Institutions** - The organisation was considered an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008, with the necessary short and long term ratings required in Banks 1 above. These institutions were subject to suitability checks before inclusion.
- **Banks 4** – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- **Building Societies** – the Council will *use* all Societies which:
  i. meet the short and long term ratings for banks outlined above

  and are:

ii. Eligible Institutions;

- **Money Market Funds** – £1m limit per fund
- **UK Government** (including gilts and the DMADF)
- **Local Authorities, Parish Councils etc**

A limit of £5m will be applied to the use of Non-Specified investments.

7.6 **Country and sector considerations** - Due care will be taken to consider the country, group and sector exposure of the Council's investments. In part the country selection will be chosen by the credit rating of the Sovereign state in Banks 1 above. In addition:

- no more than £1m will be placed with any non-UK country at any time;
- limits in place above will apply to Group companies;
- Sector limits will be monitored regularly for appropriateness.

7.7 **Use of additional information other than credit ratings** – Additional requirements under the Code of Practice 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.

7.8 **Time and Monetary Limits applying to Investments** - The time and monetary limits for institutions on the Council's Counterparty List are as follows (these will cover both Specified and Non-Specified Investments):

	Fitch (or equivalent)	**Money Limit**	**Time Limit**
Eligible Institution	LCD (short and long term ratings)	£1m	Less than one month
D.M.O.	-	Unlimited	-
Other (incl Money Market Funds)	LCD	£1m	-
Banks & Building Societies	LCD	£1m	-
Local Authorities	-	£1m	-

7.9 The proposed criteria for Specified and Non-Specified investments are shown in Annex B1 for approval.

7.10 In the normal course of the council's cash flow operations it is expected that both Specified and Non-specified investments will be utilised for the control of liquidity as both categories allow for short term investments.

7.11 The use of longer term instruments (greater than one year from inception to repayment) will fall in the Non-specified investment category. These instruments will only be used where the Council's liquidity requirements are safeguarded. This will also be limited by the longer term investment limits.

7.12 **Economic Investment Considerations** - Expectations on shorter-term interest rates, on which investment decisions are based, show likelihood of the current 0.5% Bank Rate remaining flat but with the possibility of a rise in mid/late-2011. The Council's investment decisions are based on comparisons between the rises priced into market rates against the Council's and advisers own forecasts.

7.13 **The criteria for choosing counterparties set out above provide a sound approach to investment in "normal" market circumstances. Whilst Members are asked to approve this base criteria above, under the exceptional current market conditions the Head of Central Services may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval. These restrictions will remain in place until the banking system returns to "normal" conditions. Similarly the time periods for investments will be restricted.**

7.14 Examples of these restrictions would be the greater use of the Debt Management Deposit Account Facility (DMADF – a Government body which accepts local authority deposits), Money Market Funds, and strongly rated institutions. The credit criteria have been amended to reflect these facilities.

8.0 Sensitivity to Interest Rate Movements

8.1 Future Council accounts will be required to disclose the impact of risks on the Council's treasury management activity. Whilst most of the risks facing the treasury management service are addressed elsewhere in this report (credit risk, liquidity risk, market risk, maturity profile risk), the impact of interest rate risk is discussed but not quantified. The table below highlights the estimated impact of a 1% increase/decrease in all interest rates to the estimated treasury management costs/income for next year. That element of the debt and investment portfolios which are of a longer term, fixed interest rate nature will not be affected by interest rate changes.

	2011/12 Estimated + 1%	2011/12 Estimated - 1%
Revenue Budgets	**£**	**£**
Interest on Borrowing	32,650	32,650
Related HRA Charge	-9,000	-9,000
Net General Fund Borrowing Cost	23,650	23,650
Investment income	21,090	21,090

9.0 Treasury Management Limits on Activity

9.1 There are four further treasury activity limits, which were previously prudential indicators. The purpose of these are to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if these are set to be too restrictive they will impair the opportunities to reduce costs/improve performance. The indicators are:

- Upper limits on variable interest rate exposure – This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure – Similar to the previous indicator this covers a maximum limit on fixed interest rates.

- Maturity structures of borrowing – These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

- Total principal funds invested for greater than 364 days – These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

9.2 The Council is asked to approve the limits:

	2011/12 £m	**2012/13 £m**	**2013/14 £m**
Interest rate Exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on debt only	12.0	11.5	11.5
Limits on variable interest rates based on debt only	7.0	7.0	7.0
Maturity Structure of fixed interest rate borrowing 2011/12			
		Lower	**Upper**
Under 12 months		0%	100%
12 months to 2 years		0%	100%
2 years to 5 years		0%	100%
5 years to 10 years		0%	100%
10 years and above		0%	100%
Maximum principal sums invested > 364 days			
Principal sums invested > 364 days	£m 1	£m 1	£m 1

10.0 **Performance Indicators**

10.1 The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. The Service Plan for Central Services contains one Treasury Management Performance Indicator.

- Investments – to achieve a return on external investments in excess of the 7 day rate

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

11.0 **Treasury Management Advisers**

11.1 The Council uses Sector as its treasury management consultants. The company provides a range of services which include:

- Technical support on treasury matters, capital finance issues and the drafting of Member reports;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments;

- Credit ratings/market information service comprising the three main credit rating agencies;

11.2 Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice the final decision on treasury matters remains with the Council. This service is subject to regular review.

12.0 **Member and Officer Training**

12.1 The increased Member consideration of treasury management matters and the need to ensure officers dealing with treasury management are trained and kept up to date requires a suitable training process for Members and officers. This Council has addressed this important issue by arranging both external and in house training sessions for both Members and officers together with procedure and system notes in order to ensure they are conversant with the legislation. Previous feedback includes good internal and external audit reports with no recommendations for improvements to procedures and practices. Regular briefings take place with the Chief Executive, Head of Central Services and Senior Accountant-Treasury and training courses/seminars are available to update staff on new legislation/procedures. Staff are not allowed to provide cover unless they have received the basic training.

Annex B1

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

1.0 Introduction

1.1 The CLG issued Investment Guidance in 2010, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds which are under a different regulatory regime.

1.2 The key intention of the Guidance is to maintain the current requirement for Councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the Code on 20 February 2003 and will apply its principles to all investment activity. In accordance with the Code, the Head of Central Services has produced its treasury management practices (TMPs). This part, TMP 1, covering investment counterparty policy requires approval each year.

2.0 Annual Investment Strategy

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

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Council is:

2.2 **Strategy Guidelines** – The main strategy guidelines are contained in the body of the treasury strategy statement.

2.3 **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 considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
2. A local authority, parish council or community council.

3. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 3 this covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's or Fitch rating agencies.
4. A body that is considered of a high credit quality (such as a bank or building society, although non-rated subsidiaries and low or non-rated building societies will need to be non-specified investments). For category 4 this *covers* bodies with a minimum short term rating of A-1, P-1, F1 as rated by Standard and Poor's, Moody's or Fitch rating agencies and the ratings detailed in para.7.5 for Banks 1 (ie long term, individual and support ratings).

2.4 Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies. This criteria is:-

	Fitch (or equivalent)	**Money Limit**	**Time Limit**
Eligible Institution	LCD (short and long term ratings)	£1m	Less than one month
D.M.O.	-	Unlimited	-
Other (incl Money Market Funds)	LCD	£1m	-
Banks & Building Societies	LCD	£1m	-
Local Authorities	-	£1m	-

2.5 **Non-Specified Investments** – Non-specified investments are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investments would include any sterling investments with:

	Non Specified Investment Category	**Limit (£ or %)**
a.	The Council's own banker if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.	£1m-overdraft
b.	**Building societies not meeting the basic security requirements under the specified investments**. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The Council may use such building societies which were originally considered Eligible Institutions and which meet the short and long term ratings but will restrict these type of investments to a time limit of less than one month.	£1m-less than one month in duration.

c.	Any **bank or building society** that has a minimum long term credit rating of A-, A3, A- (Fitch, Moody's and Standard and Poors for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment) and which meet the short term, individual and support ratings previously detailed.	£1m 1-3 years

Within categories a and b, and in accordance with the Code, the Council has developed additional criteria to set the overall amount of monies which will be invested in these bodies. This criteria is short and long term ratings for an organisation which was considered an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008 (b) above and for all others short, long term, individual, support and financial strength ratings (includes all other banks and building societies).

3.0 The Monitoring of Investment Counterparties

3.1 The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Sector as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Head of Central Services, and if required new counterparties which meet the criteria will be added to the list under delegated powers.

Annex B2

Security, Liquidity and Yield Benchmarking

1.0 Introduction

1.1 **Benchmarking and Monitoring Security, Liquidity and Yield in the Investment Service** - A proposed development for Member reporting is the consideration and approval of security and liquidity benchmarks.

These benchmarks are targets and so may be breached from time to time. Any breach will be reported, with supporting reasons in the Annual Treasury Report.

Yield – These benchmarks are currently widely used to assess investment performance. Local measures of yield benchmarks are:

- Investments – to achieve a return on external investments in excess of the 7 day rate

Security and liquidity benchmarks are already intrinsic to the approved treasury strategy through the counterparty selection criteria and some of the prudential indicators. However they have not previously been separately and explicitly set out for Member consideration. Proposed benchmarks for the cash type investments are below and these will form the basis of future reporting in this area. In the other investment categories appropriate benchmarks will be used where available.

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

- Bank overdraft – up to £1.0m
- Liquid short term deposits of at least £250,000 available with a week's 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 – shorter WAL would generally embody less risk. In this respect the proposed benchmark is to be used:

- WAL benchmark is expected to be 1.5 years, with a maximum of 3 years**.**

1.2 Security of the investments – In context of benchmarking, assessing security is a much more subjective area to assess. Security is currently evidenced by the application of minimum credit quality criteria to investment counterparties, primarily through the use of credit ratings supplied by the three main credit rating agencies (Fitch, Moody's and Standard and Poors). 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/Moody's Standard and Poors long term rating category over the period 1990 to 2009.

Years	1	2	3	4	5
AAA	0.00%	0.01%	0.05%	0.10%	0.17%
AA	0.03%	0.06%	0.08%	0.14%	0.20%
A	0.08%	0.22%	0.37%	0.52%	0.70%
BBB	0.24%	0.68%	1.19%	1.79%	2.42%
BB	1.22%	3.24%	5.34%	7.31%	9.14%
B	4.06%	8.82%	12.72%	16.25%	19.16%
CCC	24.03%	31.91%	37.73%	41.54%	45.22%

The Council's minimum long term rating criteria is currently A- and A3, meaning the average expectation of default for a one year investment in a counterparty with a A- and A3 long term rating would be 0.08% of the total investment (e.g. for a £1m investment the average loss would be £800). This is only an average - any specific counterparty loss is likely to be higher - but these figures do act as a proxy benchmark for risk across the portfolio.

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

- 0.08% historic risk of default when compared to the whole portfolio.

And in addition that the security benchmark for each individual year is:

	1 year	2 years	3 years	4 years	5 years
Maximum	0.06%	0.06%	0.08%	N/A	N/A

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