COUNCIL – 25TH FEBRUARY 2013

Report of the Cabinet

ITEM 7.2 TREASURY MANAGEMENT STRATEGY STATEMENT, ANNUAL INVESTMENT STRATEGY AND MINIMUM REVENUE PROVISION STRATEGY FOR 2013-14

Purpose of Report

To set out the Treasury Management Strategy Statement, the Annual Investment Strategy and Minimum Revenue Provision Strategy, for consideration and approval.

Recommendations

1. That the Treasury Management Strategy Statement, Annual Investment Strategy and Minimum Revenue Provision Strategy, as shown as an Appendix to the report of Cabinet (attached as an Annex), be approved; and

2. that the Prudential and Treasury Indicators set out in sections 2 and 3 of the Strategy be approved.

Reasons

1. To ensure that the Council's governance and management procedures for Treasury Management reflect best practice and comply with the CIPFA Treasury Management in the Public Services Code of Practice, Guidance Notes and Treasury Management Policy Statement.

2. To ensure that funding of capital expenditure is taken within the totality of the Council's financial position and that borrowing and investment is only carried out with proper regard to the Prudential Code for Capital Finance in Local Authorities.

Policy Justification and Previous Decisions

The Treasury Management Strategy Statement, Prudential and Treasury Indicators and Annual Investment Strategy must be approved by Council each year and reviewed half yearly.

At its meeting on 14th February 2013, Cabinet considered a report of the Head of Finance and Property Services setting out the Treasury Management Strategy Statement for consideration by Council as well as the Annual Investment Strategy and Minimum Revenue Provision Strategy, which is attached as an Annex.

The Cabinet resolved to recommend to Council

1. that the Treasury Management Strategy Statement, Annual Investment Strategy and Minimum Revenue Provision Strategy, attached as an Appendix to the report of the Head of Finance and Property Services, be approved; and

2. that the Prudential and Treasury Indicators set out in sections 2 and 3 of the Strategy be approved.

Cabinet's reasons for the recommendations are set out in the Reasons section above.

Implementation Timetable including Future Decisions and Scrutiny

This report will be considered by the Audit Committee at its meeting on 5th March 2013.

Report Implications

Financial Implications

There are no financial implications associated with the recommendations of the Cabinet further to those detailed in the report of the Head of Finance and Property Services, attached as an Annex.

Risk Management

There are no risks associated with the recommendations of the Cabinet further to those detailed in the report of the Head of Finance and Property Services, attached as an Annex.

Key Decision:	Yes
Background Papers:	No additional background papers.
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CABINET – 14 February 2013 **ANNEX**

Report of the Head of Finance & Property

Lead Member: Councillor T Barkley

Part A

ITEM 8 TREASURY MANAGEMENT STRATEGY STATEMENT, ANNUAL INVESTMENT STRATEGY AND MINIMUM REVENUE PROVISION STRATEGY FOR 2013-14

Purpose of Report

This report sets out the Treasury Management Strategy Statement for consideration by Council as well as the Annual Investment Strategy and Minimum Revenue Provision Strategy.

Recommendations

That Cabinet recommends to council:

1. That the Treasury Management Strategy Statement, Annual Investment Strategy and Minimum Revenue Provision Strategy as shown as an Appendix to this report;
2. That the Prudential and Treasury Indicators set out in sections 2 and 3 of the Strategy be approved

Reasons

1. To ensure that the Council's governance and management procedures for Treasury Management reflect best practice and comply with the CIPFA Treasury Management in the Public Services Code of Practice, Guidance Notes and Treasury Management Policy Statement.

2. To ensure that funding of capital expenditure is taken within the totality of the Council's financial position and that borrowing and investment is only carried out with proper regard to the Prudential Code for Capital Finance in Local Authorities.

Policy Justification and Previous Decisions

The Treasury Management Strategy Statement, Prudential and Treasury Indicators and Annual Investment Strategy must be approved by Council each year and reviewed half yearly. The Strategies for the year are set out in Appendices 1 to 4 of Part B

Implementation Timetable including Future Decisions and Scrutiny

This report will be available for Overview Scrutiny Group on 1 February 2013, should they wish to consider it, and will also be considered by the Audit Committee at its meeting on 5 March 2013.

Report Implications

The following implications have been identified for this report.

Financial Implications

There are no direct financial implications arising from this report and all relevant financial issues are covered in the strategy.

Risk Management

Risk Identified	Likelihood	Impact	Risk Management Actions Planned
Poor investment decisions due to no strategy in place	Unlikely	Moderate	Approve strategy in accordance with CIPFA guidelines and best practice
Loss of council funds through failure of borrowers	Unlikely	Major/Severe	Credit ratings and other sources used to minimise risks
Market changes rapidly during year	Possible	Minor	Although strategy in place, important to monitor position and use Treasury Consultants and other sources to provide latest advice.
Failure to take effects of Capital Expenditure, when approved, into the budgetary process.	Unlikely	Minor	Robust procedures to approve Capital Plan after all effects have been considered and evaluated by officers and members.
Exposure to interest rates moving adversely without notice	Unlikely	Major	Treasury Consultants engaged to advise of changing interest rate scenarios affecting the Council. New borrowings for the HRA will probably be at fixed rates.

Key Decision:	Yes
Background Papers:	CIPFA Code for Treasury Management in the Public Services and Cross –Sectorial Guidance Notes Local Government Act 2003 Prudential Code for Capital Finance in Local Authorities CIPFA Code for Treasury Management in the Public Services and Cross –Sectorial Guidance Notes
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Part B

Background

The Treasury Management Strategy Statement, Minimum Revenue Provision Strategy and Annual Investment Strategy must be approved by Council each year. These are all set out in the attached report.

The Treasury Management and Annual Investment Strategy have been prepared in accordance with the revised code and accordingly include:

- the treasury limits in force which will limit the treasury risk and activities of the council,
- the Prudential and Treasury Indicators
- the current treasury position,
- the borrowing requirement,
- prospects for interest rates,
- the borrowing strategy,
- policy on borrowing in advance of need,
- debt rescheduling,
- the investment strategy,
- creditworthiness policy,
- the use of external fund managers and treasury advisers,
- Minimum Revenue Provision (MRP) strategy.

Appendix:

Treasury Management Strategy Statement, Annual Investment Strategy and Minimum Revenue Provision Strategy for 2013-14

Charnwood Borough Council

Treasury Management Strategy Statement
Minimum Revenue Provision Policy Statement and
Annual Investment Strategy
2013/14

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1 INTRODUCTION

1.1 Background

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.

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.

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."*

1.2 Reporting requirements

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.

Prudential and treasury indicators and treasury strategy (this report) - covers:

- the capital plans,including prudential indicators;
- a minimum revenue provision (MRP) policy - 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.

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.

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. This is submitted to and considered by the Audit Committee.

Scrutiny
The above reports are scrutinised by the Audit Committee and are also available for consideration by the Overview Scrutiny Group.

1.3 Treasury Management Strategy for 2013/14

The strategy for 2013/14 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 limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

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

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsibe for scrutiny. Suitable training is provided for members on a periodic basis. The training needs of treasury management officers are reviewed annually.

1.5 Treasury management consultants

The Council uses Sector Treasury Servcies Limited (Sector) as its external treasury management advisors.

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

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

2 THE CAPITAL PRUDENTIAL INDICATORS 2013/14 – 2015/16

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.

2.1 Capital expenditure

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 note the capital expenditure forecasts:

Capital Expenditure £'000	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
General Fund	**6,509**	**3,083**	**1,949**	**1,027**	**1,000**
HRA	6,693	21,282	12,988	9,768	9,484
HRA settlement	79,190	0	0	0	0
HRA Total	**85,883**	**21,282**	**12,988**	**9,768**	**9,484**
Total	**92,392**	**24,365**	**14,937**	**10,795**	**10,484**

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 borrowing need

Capital Expenditure £'000	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Total as per above table	92,392	24,365	14,937	10,795	10,484
Financed by:					
Capital receipts	1,817	1,241	672	450	294
Capital grants, MRA	8,038	17,333	5,459	5,490	5,490
Capital reserves	0	264	106	62	0
Revenue	727	2,754	4,905	4,545	4,700
Internal Borrowing	2,620	0	0	0	0
External Borrowing	79,190	0	0	0	0
Net financing need for the year	**0**	**2,773**	**3,795**	**248**	**0**

2.2 The Council's borrowing need - the Capital Financing Requirement

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.

The Council is asked to note the CFR projections below:

£'000	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Capital Financing Requirement					
CFR – non housing	15	-547	-164	-164	-164
CFR - housing	-570	81,954	85,366	85,614	85,614
HRA Settlement	79,190	0	0	0	0
Total CFR	**78,635**	**81,407**	**85,202**	**85,450**	**85,450**
Movement in CFR	**81,810**	**2,772**	**3,795**	**248**	**0**

£'000	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Movement in CFR represented by					
Net financing need for the year (above)	0	2,772	3,795	248	0
HRA Settlement	79,190	0	0	0	0
Less MRP and other financing movements	2,620	0	0	0	0
Movement in CFR	**81,810**	**2,772**	**3,795**	**248**	**0**

2.3 Minimum revenue provision (MRP) policy statement

The Council currently has an overall negative capital financing requirement for the General Fund and therefore does not have to make an MRP provision. If the council, in the future, funds capital expenditure from borrowing, then a policy will need to be adopted in line with the options set out in government guidance. At that time the most appropriate option would be adopted.

No revenue charge is currently required for the HRA. However under HRA reform the HRA will be required to charge depreciation on its assets, which will have a revenue effect. In order to address any possible adverse impact, regulations allow the Major Repairs Allowance to be used as a proxy for depreciation for the first five years, and 2013-14 will be year two of the five years.

2.4 Core funds and expected investment balances

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.). The current three year General Fund Capital Plan from 2012/13 to 2014/15 is adequately funded from capital receipts, reserves and revenue funding. However, at the end of the three year period future capital expenditure will need to be funded from a combination of asset sales, revenue contributions to capital or borrowing. The need to borrow will be considered in future years' Treasury Management Strategies.

2.5 Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances.

2.6 Ratio of financing costs to net revenue stream.

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Non-HRA	-0.41	0.02	-0.32	-0.33	-0.44
HRA	7.29	14.39	12.85	13.30	13.35

The estimates of financing costs include current commitments and the proposals in the 2013/14 budget report.

2.7 Incremental impact of capital investment decisions on council tax.

This indicator identifies the revenue costs associated with proposed changes to the current three year capital programme compared to the Council's existing approved commitments and current plans. The assumptions are based on the 2013/14 budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

Incremental impact of capital in vestment decisions on the ban d D council tax

£	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Council tax - Band D	-0.79	-0.24	-1.53	-1.52	0.00

2.8 Estimates of the incremental imp act of capital investment decisions on housing rent levels.

Similar to the council tax calculation, this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in the 2013/14 budget compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

Incremental impact of capital in vestment decisions on h ousing rent levels

£	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Weekly housing rent levels	-0.10	0.00	0.00	0.00	0.00

This indicator shows the revenue impact on any newly proposed changes, although any discrete impact will be constrained by rent controls.

3 Borro wing

The capital expenditure plans set out in Section 2 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.

3.1 Current portfolio position

The Council's treasury portfolio position at 31 March 2012, with forward projections is summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement), highlighting any over or under borrowing.

£'000	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
External Debt					
Debt at 1 April	2,000	81,190	83,963	87,758	88,006
Expected change in Debt	0	2,773	3,795	248	0
HRA settlement	79,190	0	0	0	0
Actual debt at 31 March	**81,190**	**83,963**	**87,758**	**88,006**	**88,006**
The Capital Financing Requirement	**78,635**	**81,407**	**85,202**	**85,450**	**85,450**
Under / (over) borrowing	**-2,555**	**-2,556**	**-2,556**	**-2,556**	**-2,556**

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross debt 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 2013/14 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

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 the 2013/14 Budget report.

3.2 Treasury Indicators: limits to borrowing activity

The operational boundary. 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 £m	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Debt	83,963	87,758	88,006	88,006
Other long term liabilities	0	0	0	0
Total	**83,963**	**87,758**	**88,006**	**88,006**

The authorised limit for external debt. 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.

1. 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.

2. The Council is asked to approve the following authorised limit:

Authorised limit £m	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Debt	96,000	96,000	96,000	96,000
Other long term liabilities	0	0	0	0
Total	**96,000**	**96,000**	**96,000**	**96,000**

Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently:

HRA Debt Limit £m	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Total	**88,770**	**88,770**	**88,770**	**88,770**

3.3 Prospects for interest rates

The Council has appointed Sector as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the Sector central view.

Annual Average %	Bank Rate	PWLB Borrowing Rates (including certainty rate adjustment)		
		5 year	25 year	50 year
Dec 2012	0.50	1.50	3.70	3.90
March 2013	0.50	1.50	3.80	4.00
June 2013	0.50	1.50	3.80	4.00
Sept 2013	0.50	1.60	3.80	4.00
Dec 2013	0.50	1.60	3.80	4.00
March 2014	0.50	1.70	3.90	4.10
June 2014	0.50	1.70	3.90	4.10
Sept 2014	0.50	1.80	4.00	4.20
Dec 2014	0.50	2.00	4.10	4.30
March 2015	0.75	2.20	4.30	4.50
June 2015	1.00	2.30	4.40	4.60
Sept 2015	1.25	2.50	4.60	4.80
Dec 2015	1.50	2.70	4.80	5.00
March 2016	1.75	2.90	5.00	5.20

The economic recovery in the UK since 2008 has been the worst and slowest recovery in recent history, although the economy returned to positive growth in the third quarter of 2012. Growth prospects are weak and consumer spending, the usual driving force of recovery, is likely to remain under pressure due to consumers focusing on repayment of personal debt, inflation eroding disposable income, general malaise about the economy and employment fears.

The primary drivers of the UK economy are likely to remain external. 40% of UK exports go to the Eurozone so the difficulties in this area are likely to continue to hinder UK growth. The US, the main world economy, faces similar debt problems to the UK, but urgently needs to resolve the fiscal problems now that the the Presidential elections are out of the way. The resulting US fiscal tightening and continuing Eurozone problems will depress UK growth and is likely to see the UK deficit reduction plans slip.

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

- The Eurozone sovereign debt difficulties provide a clear indication of high 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 2013/14 and beyond;
- Borrowing interest rates continue to be attractive and may remain relatively low for some time. The timing of any borrowing will need to be monitored carefully;
- There will remain a cost of carry – any borrowing undertaken that results in an increase in investments will incur a revenue loss between borrowing costs and investment returns.

3.4 Borrowing strategy

The Council is currently maintaining an over-borrowed position. This means that the level of borrowing exceeds the capital borrowing need (the Capital Financing Requirement). The over-borrowing is currently £2,556k and this is primarily due to an old £2m loan which is not economic to repay due to the high premium that would be charged. The remaining £556k is due to the HRA having a negative CFR prior to the HRA settlement in 2011/12.

It is not envisaged that this situaution will change over the life of this strategy and is managaeable within the Council's revenue postion as set out in the current Medium Term Fiancial Stategy. At present it is not anticipated that further borowings, except as identified for the HRA, will be made over the next three years.

Treasury management limits on activity

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any 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. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure 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.

%	2013/14	2014/15	2015/16
Interest rate exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100	100	100
Limits on variable interest rates based on net debt	90	90	90
Maturity structure of fixed interest rate borrowing 2013/14			
		Lower	**Upper**
Under 12 months		0%	5%
12 months to 2 years		0%	10%
2 years to 5 years		0%	20%
5 years to 10 years		0%	50%
10 years and above		0%	100%
Maturity structure of variable interest rate borrowing 2013/14			
		Lower	**Upper**
Under 12 months		0%	5%
12 months to 2 years		0%	10%
2 years to 5 years		0%	20%
5 years to 10 years		0%	40%
10 years and above		0%	100%

3.5 Policy on borrowing in advance of need

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 that value for money can be demonstrated and that the Council can ensure the security of such funds.

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

3.6 Debt rescheduling

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, the Council currently has one long term variable rate debt which matures in 2024 and it carries a current interest rate of 11.625%. The cost of replacing this debt is prohibitive and this position is unlikely to change in the next three years.

The £79.19m of HRA debt is at fixed interest rates and the twenty four loans are repayable from 2024 to 2061. Their maturity dates are set to match income and expenditure levels in the HRA Business Plan and they will be

reviewed in line with that plan. However, the primary objective of the plan over the next few years is to invest in the Council's housing stock and this position is not expected to change in the near future. Therefore these debts are unlikely to be rescheduled over the next three years.

4. ANNUAL INVESTMENT STRATEGY

a. Investment policy

The Council's investment policy has regard to the CLG's 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 and then return.

In accordance with guidance from the CLG and CIPFA, 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, watches and outlooks published by all three ratings agencies with a full understanding of what these reflect in the eyes of each agency. Using the Sector ratings service potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

Furthermore, 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 continually 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" and overlay that information on top of the credit ratings. This is fully integrated into the credit methodology provided by the advisors, Sector, in producing its colour codings which show the varying degrees of suggested creditworthiness.

Other information sources used will include the financial press and media, 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.

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

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

Investment instruments identified for use in the financial year are listed in appendix 2 under the ‘specified’ and ‘non-specified’ investments categories.

b. Creditworthiness policy

This Council applies the creditworthiness service provided by Sector. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody’s and Standard and Poor’s. 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.

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 suggested duration for investments. The Council will therefore use counterparties within the following durational bands

- Purple 2 years
- 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

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.

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-, viability rating of A-, and a support rating of 1. 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.

All credit ratings will be monitored at least weekly and changes are sometimes made on a daily basis to reflect any downgradings. 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. For any investemnts with an institution that suffers a downgrade then advice will be sought as to whether to allow the investment to run through to maturity or whether the Council should seek to redeem the investment before maturity.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in the downgrade of an institution or removal from the Council's lending list.

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

c. Countr y limits

The Council has determined that it will only use approved counterparties from countries with 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 3. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

d. Investment strategy

In-house funds. 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).

Investment returns expectations. Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 1 of 2015. Bank Rate forecasts for financial year ends (March) are:

- 2013/14 0.50%
- 2014/15 0.75%
- 2015/16 1.75%

There are downside risks to these forecasts (i.e. start of increase 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.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to three months during each financial year for the next three years are as follows, with Charnwood's target in-house rates in brackets:

2013/14	0.50%	(1.48%)

2014/15	0.60%	(1.52%)
2015/16	1.50%	(1.64%)

Investment treasur y indicator and limit - total principal funds are not invested by the in-house team for greater than 364 days. This limit is 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 periodic availability of funds.

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 364 days) in order to benefit from the compounding of interest.

e. Icelandic bank investments

In 2008 the Council had an investment of £1m with the Heritable Bank Plc ('Heritable') which was a subsidiairy of one of the failed Icelandic banks. This resulted in the Heritable going into administation in October 2008. As at the end of Jnauary 2013 the Council has received £802k from the administrators and a final settlement in the range of 86p to 90p in the £ is predicted by the administrators.

f. End of year investment report

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

g. External fund managers

£9.7m of the Council's funds are externally managed on a discretionary basis by Investec Asset Management Ltd.

The Council's external fund manager will comply with the Annual Investment Strategy. The agreement between the Council and the fund manager additionally stipulates guidelines and duration and other limits in order to contain and control risk.

The minimum credit criteria to be used by the cash fund manager are set out in appendix 2.

Appendices

1. Interest rate forecasts

2. Treasury management practice - credit and counterparty risk management

3. Approved countries for investments

APPENDIX 1: Interest Rate Forecasts 2013 - 2016

Sector's Interest Rate View														
	Now	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Sector's Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%
3 Month LIBID	0.39%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.60%	0.60%	0.70%	0.80%	1.10%	1.40%	1.70%
6 Month LIBID	0.54%	0.70%	0.70%	0.70%	0.70%	0.70%	0.70%	0.80%	0.90%	1.00%	1.10%	1.30%	1.60%	1.90%
12 Month LIBID	0.88%	1.00%	1.00%	1.00%	1.00%	1.00%	1.10%	1.10%	1.20%	1.30%	1.30%	1.50%	1.80%	2.10%
5yr PWLB Rate	1.85%	1.50%	1.50%	1.60%	1.60%	1.70%	1.70%	1.80%	2.00%	2.20%	2.30%	2.50%	2.70%	2.90%
10yr PWLB Rate	2.87%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	3.00%	3.20%	3.30%	3.50%	3.70%	3.90%
25yr PWLB Rate	4.02%	3.80%	3.80%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.30%	4.40%	4.60%	4.80%	5.00%
50yr PWLB Rate	4.15%	4.00%	4.00%	4.00%	4.00%	4.10%	4.10%	4.20%	4.30%	4.50%	4.60%	4.80%	5.00%	5.20%
Bank Rate														
Sector's View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%
UBS	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	-	-	-	-	-
Capital Economics	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	-	-	-	-	-
5yr PWLB Rate														
Sector's View	1.85%	1.50%	1.50%	1.60%	1.60%	1.70%	1.70%	1.80%	2.00%	2.20%	2.30%	2.50%	2.70%	2.90%
UBS	1.85%	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital Economics	1.85%	1.55%	1.30%	1.30%	1.30%	1.30%	1.30%	1.50%	1.60%	-	-	-	-	-
10yr PWLB Rate														
Sector's View	2.87%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	3.00%	3.20%	3.30%	3.50%	3.70%	3.90%
UBS	2.87%	3.00%	3.10%	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	-	-	-	-	-
Capital Economics	2.87%	2.55%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	-	-	-	-	-
25yr PWLB Rate														
Sector's View	4.02%	3.80%	3.80%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.30%	4.40%	4.60%	4.80%	5.00%
UBS	4.02%	4.20%	4.30%	4.40%	4.50%	4.50%	4.50%	4.50%	4.50%	-	-	-	-	-
Capital Economics	4.02%	3.70%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	-	-	-	-	-
50yr PWLB Rate														
Sector's View	4.15%	4.00%	4.00%	4.00%	4.00%	4.10%	4.10%	4.20%	4.30%	4.50%	4.60%	4.80%	5.00%	5.20%
UBS	4.15%	4.30%	4.40%	4.50%	4.60%	4.60%	4.60%	4.60%	4.60%	-	-	-	-	-
Capital Economics	4.15%	4.00%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	-	-	-	-	-

APPENDIX 2 Specified and Non-Specified Investments and Limits

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum 'high' colour criteria where applicable. A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

The criteria in this appendix are intended to be the operational criteria in normal times. At times of heightened volatility, risk and concern in financial markets, this strategy may be amended by temporary operational criteria further limiting investments to counterparties of a higher creditworthiness and/or restricted time limits

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

	Minimum credit criteria / colour band	**Max % of total investments or £ limit per institution**	**Max. maturity period**
DMADF – UK Government, including Treasury Bills	N/A	100%	12 months
Bonds issued by multilateral development banks	UK credit rating	10% - Fund Manager only	12 months
Money market funds	AAA	£4m any one institution and £10m in total.	Liquid
Local authorities	N/A	£3m any one institution and £6m in total	12 months
Term deposits with banks and building societies	Purple Blue Orange Red Green	£6m per institution and £10.0m in total. £6m per institution and £12m in total. £6m per institution and £9.0m in total. £5m per institution and £7.5m in total. £4m per	Up to 2 years Up to I year Up to 12 Months Up to 6 months

	No Colour	institution and £12.5m in total. Nil	Up to 3 months Not for use
	Minimum credit criteria / colour band	**Max % of total investments or £ limit per institution**	**Max. maturity period**
CDs or corporate bonds with banks and building societies	Short term F1, Long term A-, Individual C-, Support 3	Fund Mangers only	3 years

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

NON-SPECIFIED INVESTMENTS : These are any investments which do not meet the Specified Investment criteria. Only the Fund Managers use Non-Specified investments and they have a maximum exposure of 20% with any institution and average maturity shall not exceed three years. The Authority currently has £9.7m invested through the Fund Managers.

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

	Minimum Credit Criteria	Max % of total investments	Max. maturity period
Fixed term deposits with variable rate and variable maturities: -Structured deposits	Short term F1, Long term A-, Individual C-, Support 3	50% restriction above 364 days	10 years
Certificates of deposit issued by banks and building societies	Short term F1, Long term A-, Individual C-, Support 3	50% restriction above 364 days	10 years
Corporate Bonds (Euro Commercial Paper)	Short term F1, Long term A-, Individual C-, Support 3	25% restriction above 364 days	10 years
	Minimum Credit Criteria	**Max % of total investments**	**Max. maturity period**
UK Government gilts	UK sovereign credit rating	50% restriction above 364 days	10 years
Bonds issued by multilateral development banks	UK sovereign credit rating	50%	Not to exceed 10 years
Bonds issued by a financial institution which is guaranteed by the UK government	UK sovereign credit rating	50% restriction above 364 days	Not to exceed 2 years
Sovereign bond issues (ie other than the UK government)	AA+	50%	Not to exceed 10 years
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs):			

1. - Bond Funds	Long term AAA volatility rating	50% restriction above 364 days	Open ended
2. - Gilt funds	Government backed and AAA	50% restriction above 364 days	Open ended

APPENDIX 3 : Approved countries for investments

Based on lowest available rating an dthis schedule is for information only as these ratings may change during the year.

AAA

- Australia
- Canada
- Denmark
- Finland
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland
- U.K.

AA+

- France
- Hong Kong
- U.S.A.