Report of the Cabinet

ITEM 6.1 TREASURY MANAGEMENT STRATEGY STATEMENT, ANNUAL INVESTMENT STRATEGY AND MINIMUM REVENUE PROVISION STRATEGY FOR 2012-13

Purpose of Report

To set out the Treasury Management Strategy Statement for consideration by Council as well as the Annual Investment Strategy and Minimum Revenue Provision Strategy.

Recommendation

1. that the Treasury Management Strategy Statement, Annual Investment Strategy and Minimum Revenue Provision Strategy, as shown in Appendices 1 to 4 of the Annex of the report filed with these minutes, be approved and adopted from 28th February 2012; and

2. that the Prudential and Treasury Indicators, as set out in sections 2 and 3 of Appendix 1 of the Annex of the report filed with these minutes, be approved and adopted from 28th February 2012 .

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 of the Annexed report.

Background

At its meeting on 19th January 2012, , Cabinet considered a report of the Head of Finance and Property Services, detailing the Treasury Management Strategy Statement (TMSS), the Annual Investment Strategy and the Minimum Revenue Provision Strategy. The report is attached as an Annex.

The Cabinet approved the recommendations in the report of the Head of Finance and Property Services. Those recommendations, along with the reasons for them, are detailed above.

Alterations to the TMSS

Since 19th January 2012 the Government has announced the final amount that the Council will need to borrow in respect of the HRA Reform which comes into effect on 1st April 2012. This amount is £565k lower than the figure notified in late 2011 and consequently several of the tables in sections 2 and 3 of Appendix 1 of the TMSS have been corrected to reflect the new figure and to align with the final version of the HRA 30 Year Business Plan and the 2012/13 Final Budgets. In this way, the strategy will reflect the actual position rather than the assumed one based on best evidence at 19th January 2012.

The government announced on 16th February 2012 some changes to the instruments that Councils are allowed to invest in. One of these is corporate bonds and this had been included as a potential opportunity in the 19th January 2012 report. The wording in Appendix 3 of the Treasury Management Strategy Statement (TMSS) has now been amended to reflect the fact that the Council is now allowed to invest in corporate bonds.

Appendix 4 of the TMSS, which shows the investment status of various countries, has also been updated as there have been some changes since January.

None of these changes affect the strategies etc as recommended by Cabinet to Council. The changes have been made to ensure that the most up to date facts are put before Council before decisions are made by members on these strategies.

Background Papers: None specific to the referral to Council

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CABINET – 19 January 2012

Report of the Head of Finance & Property

Lead Member: Councillor T Barkley

Part A

ITEM 11 **Treasury Management Strategy Statement, Annual Investment Strategy and Minimum Revenue Provision Strategy for 2012-13**

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 in Appendices 1 to 4 of Part B be approved;
2. That the Prudential and Treasury Indicators set out in sections 2 and 3 of Appendix 1 of Part B 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 16 January 2012, should they wish to consider it, and will also be considered by the Audit Committee at its meeting on 6 March 2012.

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 Appendices 1 to 4 of Part B.

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 as Appendices 1 to 4.

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.

There are certain changes to the strategies for 2012-13, namely:

1. Major changes to the borrowing requirement and Capital Financing Requirement in respect of the funding of the debt payment for the removal of the Housing subsidy system (HRA reform) and additional borrowing for Housing capital expenditure (see sections 2 and 3 of Appendix 1);
2. Changes to the credit worthiness requirements for institutions following a series of downgradings during the year and the current continuing economic difficulties facing the UK and other countries (see Appendix 3).

Appendix 1

Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

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Charnwood Borough Council
2012/13

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. These reports are required to be adequately scrutinised by the Audit Committee and also by the Overvew Scrutiny Group, should the latter choose to scrutinise the relevant reports.

Prudential and Treasury Indicators and Treasury Strategy, as included in this report, which 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).

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.

1.3 Treasury Management Strategy for 2012/13

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;
- 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, the CLG MRP Guidance, the CIPFA Treasury Management Code and the CLG Investment Guidance.

2. The Capital Prudential Indicators 2012/13 – 2014/15

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

A key issue facing the Council is the impact of planned HRA reform. This would essentially end the impact of the housing subsidy system and will see the HRA as a stand alone business. The final amounts have yet to be notified but the Council will need to approve revised limits in expectation of the draft figures.

The Council currently pays into the HRA housing subsidy system, and in order to stop future payments from 1 April 2012 the Council is required to pay the CLG £79.190m. This payment is effectively HRA debt, and so the prudential indicators have been adjusted to reflect this change. The actual payment will be made on 28 March 2012 and so the indicators will take immediate effect from the approval of these limits by Council. The change is expected to be beneficial to the Council.

Capital Expenditure. This prudential Indicator is a summary of the Council's draft capital expenditure plans, both those agreed previously, and those forming part of the Proposed New Capital Plan, 2012/13 to 2014/15.

Capital Expenditure £'000	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
General Fund	**5,951**	**6,675**	**1,690**	**1,187**	**1,027**
HRA existing	5,519	8,509	13,036	15,569	12,908
HRA settlement	0	79,190	0	0	0
HRA	**5,519**	**87,699**	**13,036**	**15,569**	**12,908**
Total	**11,470**	**94,374**	**14,726**	**16,756**	**13,935**

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).

Capital Expenditure £'000	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Totals as per above table	11,470	94,374	14,726	16,756	13,935
Financed by:					
Capital receipts	1,812	2,608	979	590	450
Capital grants, MRA	9,011	12,383	9,023	8,617	9,318
Capital reserves	0	193	72	87	62
Revenue	647	0	2,511	3,035	3,946
Net financing need for the year	**0**	**79,190**	**2,141**	**4,427**	**159**

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 CFR projections are shown below:

£'000	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Capital Financing Requirement					
CFR – non housing	-22	-2,077	-1,845	-1,299	-601
CFR - housing	-3,148	-570	80,761	85,189	85,348
HRA Settlement	0	79,190	0	0	0
Total CFR	**-3,170**	**76,543**	**78,916**	**83,890**	**84,747**
Movement in CFR	**0**	**79,713**	**2,373**	**4,974**	**857**

Movement in CFR represented by					
Net financing need for the year (above)	0	523	2,373	4,974	857
HRA Settlement	0	79,190	0	0	0
Less MRP and other financing movements	0	0	0	0	0
Movement in CFR	**0**	**79,713**	**2,373**	**4,974**	**857**

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 will allow the Major Repairs Allowance to be used as a proxy for depreciation for the first five years.

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

The application of resources (capital receipts, reserves etc.) to finance capital expenditure will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). The proposed new 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.

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.

Actual and estimates of the 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.

%	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Non-HRA	-0.28	0.15	0	-0.10	-0.75
HRA (inclusive of settlement)	6.03	1.96	15.51	15.18	14.89

The estimates of financing costs include current commitments and the proposals in the draft 2012/13 budget report.

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

This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in the draft Capital Plan 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.

Incremental impact of capital investment decisions on the band D council tax

£	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Council tax - band D	-£2.13	-0.71	-1.39	-1.39	-1.39

Estimates of the incremental impact 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 draft capital Plan compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

Incremental impact of capital investment decisions on housing rent levels

£	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Weekly housing rent levels	0	-0.10	0	0	0

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

3. Treasury Management Strategy

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 2011, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£'000	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
External Debt					
Debt at 1 April	2,000	2,000	81,190	83,332	87,759
Expected change in Debt	0	0	2,142	4,427	159
HRA settlement	0	79,190	0	0	0
Actual debt at 31 March	**2,000**	**81,190**	**83,332**	**87,759**	**87,918**
The Capital Financing Requirement	**-3,170**	**76,543**	**78,916**	**83,890**	**88,077**
Under / (over) borrowing	**1,170**	**-4,647**	**-4,416**	**-3,869**	**159**

£'000	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Total investments at 31 March					
Investments	16,800	16,800	16,800	16,800	16,800

Net Debt	**-14,800**	**64,390**	**66,532**	**70,959**	**71,118**

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 total debt, 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 2012/13 and the following two financial years (shown as net borrowing above). 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 current draft budget reports.

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	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Debt	5,000	8,000	12,500	13,500
Add HRA settlement	79,190	79,190	79,190	79,190
Total	84,190	87,190	91,690	92,690

The Authorised Limit for external debt.

A further key prudential indicator represents a control on the maximum level of debt. 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	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Debt	17,500	17,500	17,500	17,500
Add HRA settlement	79,190	79,190	79,190	79,190
Total	96,690	96,690	96,690	96,690

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	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 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	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

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 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.

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.

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.

3.4 Borrowing Strategy

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used to fund capital expenditure. This strategy is prudent as investment returns are low and counterparty risk is high. However, there are insufficent internal funds to finance capital expenditure on the council's housing stock and it is expected that the Council will be 'over-borrowed' until 2014/15.

Against this background and the risks within the economic forecast, caution will be adopted with the 2012/13 treasury operations. Officers will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

The requirement for the HRA reform settlement to be made to the CLG on 28 March 2012 will require a separate consideration of a borrowing strategy. The Council will need to have the cash settlement amount of £79.190m available by 28 March 2012, so separate borrowing solely for this purpose is anticipated. The PWLB are providing loans at interest rates approximately 0.85% lower than the usual PWLB interest rates solely for the settlement requirements. This provides a compelling reason to utilise this borrowing availability. The exact structure of debt to be drawn is currently being considered by officers to ensure it meets the requirements of the HRA business plan and the overall requirements of the Council.

The Council will borrow the £79.190m in various tranches on 28 March 2012 for repayment over the 30 year period of the business plan and beyond. The current draft model shows that the Council will be unlikely to have any surplus funds for at least the first 10 years of the HRA Plan. Therefore it is unlikely that any borrowing will be scheduled for repayment within this period in view of the current historically low interest rates. In addition, the model indicates that the Council can afford to borrow an additional £9.579m as well as the £79.190m needed to repay the government.

It is likely that up to £6.661m will be borrowed over the next three years in order to expedite capital expenditureon the housing stock, and there is scope to borrow a further £1.918m in subsequent years making a potential total additional borrowing of £8.579m. It is not intended at the present time to draw down the remaining £1m in order to provide a buffer for unforeseen circumstances such as a major flood or storm. This

additional borrowing will probably be from the PWLB and so-called 'internal borrowing'. The PWLB borrowing will be at their normal rates without the 0.85% reduction which is only allowed for the actual settlement to the government in respect of the HRA. The 'internal borrowing' is where some of this additional amount may be lent by the General Fund to the HRA at appropriate rates. This should allow the HRA to borrow at rates similar to those offfered by the PWLB and allow the General Fund to receive a better rate of interest then it does on ts investments at present without incurring additional risk. Any internal borrowing will be reviewed each year and rates decided on an agreed basis by the S.151 Offcier to provide budget certainty to both the HRA and General Fund.

The borrowing schedule for the HRA has been discussed with the Council's treasury advisers and will be finally agreed by the S.151 Officer on 26 March 2012. As stated above it is intended to take advantage of the current low rates whilst ensuring flexilibility for the Councill in the medium/longer term, 10 years plus, to pay down some of the debt should it wish to do so.

As part of a technical exercise, the council's borrowings will be split into two pools in future with one for the HRA and one for the General Fund. Whilst all borrowings will be in the council's name this will allow the suitable apportionment of interest and treasury management costs. The existing £2.0m borrowing will be split between the two pools with the majority probably being apportioned to the General Fund.

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. These are the proposed treasury indicators and limits:

£m	2012/13	2013/14	2014/15
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 2012/13			
		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%
Maturity Structure of variable interest rate borrowing 2012/13			
		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 only one long term debt and this does not mature until 2024 and is at an interese rate of 11.625%. The cost of replacing this debt is currently unattractive and this position is unlikley to change in the medium term. Therefore the councill is not considering any rescheduling of debt in the next year.

3.7. Annual Investment Strategy

3.7.1 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, then return.

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 agency. 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.

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" and overlay that information on top of the credit ratings. This is encapsulated within the credit methodology provided by the advisors, Sector.

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.

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 3 under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

3.7.2 Creditworthiness policy

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.

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:

- 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

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.

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.

All credit ratings will be monitored at least weekly and changes are often 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 investments 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 it before maturity.
- 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.

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.

3.7.3 Country 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 4. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

For any investments with an institution that suffers a soverign downgrade, ie the country goes out of range, 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 it before maturity.

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, then return.

3.7.4 Investment Counterparty Selection Criteria

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 in Appendix 3; 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.

The Council maintains a counterparty list in compliance with the Creditworthiness policy set out above.

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 (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.

The criteria for providing a pool of high quality investment counterparties, both Specified and Non-specified investments, is set out in more detail in appendix 3.

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 of the institution.

Use of additional information other than credit ratings

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.

3.7.5 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 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%

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.

The suggested budgeted investment earnings rates from Sector 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:

2012/13	0.70%	(1.30%)
2013/14	1.00%	(1.45%)
2014/15	1.60%	(2.06%)

Charnwood's target rates are higher as we anticpate having one investment for longer than 3 months which increases the return.

Invesment treasury indicator and limit. 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. Only the external invesment managers may place investments for more than one year.

For its cash flow generated balances, the Council will seek to utilise its business reserve accounts, 15 and 30 day notice accounts, money market funds and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

3.8 End of year investment report

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

3.9 External fund managers

£10.6m 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 stipulate guidelines and durations 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 3.

3.10 Policy on the use of external service providers

The Council uses 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.

Appendices

2 Interest Rate Forecast

3 Treasury Management practice - Specified and non specified investments and limits

4 Approved countries for investments

APPENDIX 2 - Interest Rate Forecast 2011/2015

Sector's Interest Rate View															
	Now	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Sector's Bank Rate View	**0.50%**	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	2.00%	2.25%	2.50%
3 Month LIBID	**0.87%**	0.70%	0.70%	0.70%	0.70%	0.70%	0.75%	0.80%	0.90%	1.20%	1.40%	1.60%	2.10%	2.40%	2.60%
6 Month LIBID	**1.16%**	1.00%	1.00%	1.00%	1.00%	1.00%	1.10%	1.20%	1.40%	1.60%	1.80%	2.00%	2.50%	2.70%	2.90%
12 Month LIBID	**1.65%**	1.50%	1.50%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.20%	2.40%	2.60%	3.10%	3.20%	3.30%
5yr PWLB Rate	**2.25%**	2.30%	2.30%	2.30%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.10%	3.30%	3.50%	3.70%
10yr PWLB Rate	**3.33%**	3.30%	3.30%	3.30%	3.40%	3.40%	3.50%	3.60%	3.70%	3.80%	4.00%	4.20%	4.40%	4.60%	4.80%
25yr PWLB Rate	**4.24%**	4.20%	4.20%	4.20%	4.30%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%
50yr PWLB Rate	**4.26%**	4.30%	4.30%	4.30%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.30%
Bank Rate															
Sector's View	**0.50%**	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	2.00%	2.25%	2.50%
UBS	**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%	0.50%	-	-	-	-	-
5yr PWLB Rate															
Sector's View	**2.25%**	2.30%	2.30%	2.30%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.10%	3.30%	3.50%	3.70%
UBS	**2.25%**	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital Economics	**2.25%**	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	-	-	-	-	-
10yr PWLB Rate															
Sector's View	**3.33%**	3.30%	3.30%	3.30%	3.40%	3.40%	3.50%	3.60%	3.70%	3.80%	4.00%	4.20%	4.40%	4.60%	4.80%
UBS	**3.33%**	3.45%	3.45%	3.50%	3.60%	3.65%	-	-	-	-	-	-	-	-	-
Capital Economics	**3.33%**	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	-	-	-	-	-
25yr PWLB Rate															
Sector's View	**4.24%**	4.20%	4.20%	4.20%	4.30%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%
UBS	**4.24%**	4.80%	4.90%	4.90%	4.90%	4.90%	-	-	-	-	-	-	-	-	-
Capital Economics	**4.24%**	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	-	-	-	-	-
50yr PWLB Rate															
Sector's View	**4.26%**	4.30%	4.30%	4.30%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.30%
UBS	**4.26%**	4.80%	4.95%	4.95%	5.00%	5.00%	-	-	-	-	-	-	-	-	-
Capital Economics	**4.26%**	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	-	-	-	-	-

APPENDIX 3 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' quality 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	AAA	10% - Fund Manager only	12 months
Money market funds	AAA	£4m any one institution and £8m 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	£6m per institution and £10.0m in total.	Up to 2 years
	Blue	£6m per institution and £11.25m in total.	Up to 1 year
	Orange	£6m per institution and £9.0m in total.	Up to 12 Months
	Red	£5m per institution and £7.5m in total.	Up to 6 months
	Green	£4m per institution and £12.5m in total.	Up to 3 months
	No Colour	Nil	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 treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

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 10% with any institution and average maturity shall not exceed three years. The Authority currently has £10.6m 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) – See note below	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	AA+	50% restriction above 364 days	10 years
Bonds issued by multilateral development banks	AAA or government guarantee	50%	Not to exceed 10 years
Bonds issued by a financial institution which is guaranteed by the UK government	AAA	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

Corporate Bonds Note: The proposals for local authorities to use commercial paper within their treasury strategy were agreed by the government on 16 February 2012. We wish to include these instruments as an option for the year ahead, but they will only be utilised upon confirmation from the S.151 Officer that the final proposals and risks and benefits involved are acceptable.

Appendix 4 - Approved countries for investments as at 10 February 2012

Based on lowest available ratings and this 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+

- Hong Kong
- France
- USA