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Report to Council

29 FEBRUARY 2012

LEADER	**TREASURY MANAGEMENT STRATEGY REPORT**	**Ward(s)**
Councillor Stephen Greenhalgh	The report provides information on the Council's Treasury Management Strategy for 2012/13. It seeks approval for borrowing limits and authorisation for the Executive Director of Finance and Corporate Governance to arrange the Council's cashflow, borrowing and investments in the year 2012/13. The report seeks approval to changes recommended by Cipfa to the Treasury Management Policy Statement and Treasury Management Practices. The report explains the treasury management implications of HRA Reform and seeks approval to the treatment of debt and interest on HRA receipts and balances with effect from 1 April 2012.	All

CONTRIBUTORS

EDFCG

Recommendations:

1. **To approve the future borrowing and investment strategies and authorise the Executive Director of Finance and Corporate Governance to arrange the Council's cashflow, borrowing and investments in 2012/13.**

2. **In relation to the Council's overall borrowing for the financial year 2012/13, approve the Prudential Indicators as set out in Section 3 of this report.**

3. **To agree the changes to the Treasury Management Policy Statement and the Treasury Management Practices as explained in section 1 of the report and reproduced in Appendices A and B.**

4. **To move to a separate HRA and General Fund debt pool with effect from 1 April 2012.**

5. **To pay the HRA investment income on unapplied HRA receipts and other HRA cash balances calculated at the average rate of interest earned on temporary investments with effect from 1 April 2012.**

1. INTRODUCTION

Background

1.1 Treasury Management is defined by the CIPFA Code of Practice 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 A revised CIPFA Code of Practice on Treasury Management in Public Service and guidance notes were published in November 2011. These documents were revised to take account of the treasury implications of the HRA reform which is discussed below in paragraphs 18 to 20. It also makes some changes to the Treasury Management Policy Statement and Treasury Management Practices which have been reproduced in full in Appendices A and B respectively. *The changes have been highlighted in red and italics.*

1.3 The Council is required to receive and approve, as a minimum, three main reports each year: a treasury Strategy Report, Mid-year report and an Outturn report. These reports are required to be adequately scrutinised by committee before being recommended to the Council. This role is undertaken by the Audit and Pensions Committee.

1.4 The Treasury Management Strategy for 2012/13 in respect of the following aspects of the treasury management function is based upon the Treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor. The strategy covers:

- treasury limits in force which will limit the treasury risk and activities of the Council;
- prudential indicators
- the current treasury position;
- prospects for interest rates;
- the borrowing strategy;
- the investment strategy;
- debt rescheduling;
- 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 CIPFA Treasury Management Code and CLG Investment Guidance.

2. TREASURY MANAGEMENT STRATEGY

2.1 The treasury management function ensures that the Council's cash is organised in accordance with 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 appropriate borrowing facilities. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy.

3. CURRENT PORTFOLIO POSITION

3.1 The Council's treasury portfolio is summarised below. The table shows the actual external borrowing (the treasury management operations), against the capital borrowing need (the Capital Financing Requirement – CFR), highlighting any over or under borrowing.

Table 1- Current Portfolio Position

£'000	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Borrowing at 1st April	475,520	262,166	262,066	250,051
Expected change in borrowing	(16,000)	(100)	(11,556)	(2,252)
HRA Settlement	(197,354)	0	0	0
Actual Borrowing at 31st March	262,166	262,066	250,510	247,799
Total investments at 31 March	(75,000)	(90,000)	(108,000)	(113,000)
Net borrowing	187,166	172,066	142,510	134,799
Other long-term liabilities (OLTL)31 March	13,078	12,164	11,214	10,264
CFR – the borrowing need	329,106	311,380	285,468	283,045

3.2 The Executive Director of Finance and Corporate Governance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

4. TREASURY INDICATORS – LIMITS TO BORROWING ACTIVITY

4.1 **The Operational Boundary.** This indicator is the focus of day to day treasury management activity within the authority. It is a means by which the Council manages its external debt to ensure that it remains within the self imposed Authorised Limit. Sustained breaches of the Operational Boundary would give an indication that the authority may be in danger of stepping beyond the Prudential boundaries it set itself.

Table 2 – Operational Boundary

Operational boundary £'000	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Borrowing	488,134	271,373	256,226	268,118
HRA Settlement	(197,354)			
Other long term liabilities	13,078	12,164	11,214	10,264
Total	303,858	283,537	267,440	278,382

4.2 **The Authorised Limit for external borrowing**. This is a control on the maximum level of borrowing and this limit needs to be set or revised by the full Council. It reflects the level of external borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

Table 3 – Authorised Limit

Authorised limit £'000	2011/12 Estimate	2012/13 Estimates	2013/14 Estimates	2014/15 Estimates
Borrowing	548,909	338,287	305,447	303,055
Add HRA settlement	(197,354)			
Other long term liabilities	13,078	12,164	11,214	10,264
Total	364,633	350,451	316,661	313,319

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

Table 4 – HRA Capital Finance Requirement

HRA Debt Limit £'000	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Total	217,427	217,344	207,733	205,312

5. PROSPECTS FOR INTEREST RATES

5.1 The Council appointed Sector Treasury Services as treasury adviser to the Council and part of their service is to assist the Council to formulate a view on interest rates. The following table gives Sector's view:

Table 5 - Interest Rates

Annual Average %	Bank Rate	Money Rates		PWLB Borrowing Rates		
		3 months	1 years	5 years	25 years	50 years
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
Dec 2012	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	0.75	0.80	1.80	2.60	4.50	4.60
Sept 2013	1.00	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

5.2 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 successive 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 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.

5.3 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.

5.4 This challenging and uncertain economic outlook has a several key treasury management 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.

6. BORROWING STRATEGY

6.1 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 as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is high.

7. TREASURY MANAGEMENT LIMITS ON ACTIVITY

7.1 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.

7.2 The Council is asked to approve the following treasury indicators and limits:

Table 6 – Interest Rate Exposure

£m	**2012/13**	**2013/14**	**2014/15**
Interest rate exposures			
	Upper	Upper	Upper
Limits on fixed interest rates based on net debt	330,000	311,000	286,000
Limits on variable interest rates based on net debt	66,000	62,200	57,200
Maturity structure of fixed rate borrowing during 2012/13		Upper Limit	Lower Limit
Under 12 months		15%	0%
12 months and within 24 months		15%	0%
24 months and within 5 years		60%	0%
5 years and within 10 years		75%	0%
10 years and above		100%	0%

8. POLICY ON BORROWING IN ADVANCE OF NEED

8.1 Any decision to borrow if necessary in advance of need 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.

9. DEBT RESCHEDULING

9.1 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 to short term debt. However, these savings will need to be considered in the light of the current treasury position and premiums incurred in prematurely repaying debt.

9.2 The reasons for any rescheduling to take place will include:

- Generating cash savings.
- Enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

9.3 Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

9.4 As part of the HRA reform the Council will receive monies from the CLG in the form of debt redemption. Under this scenario a proportion of the HRA debt will be repaid by the CLG on 28 March 2012. The Council will not have influence over this debt redemption and so a proportion of each PWLB loan will be repaid automatically.

10. ANNUAL INVESTMENT STRATEGY

10.1 The Council must have regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA's Treasury Management in Public Services of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

10.2 Although the annual investment strategy has to be approved by full Council, it is proposed that amendments to the investment methodology are delegated to Cabinet to enable changes to be made on a timely basis to reflect changes in market conditions.

10.3 The Council's investments priorities are:-

(a) the security of capital and
(b) the liquidity of its investments.

The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investments.

10.4 In accordance with the above, and in order to minimise the risk to investments, the Council has clearly stipulated below the minimum acceptable credit quality of counterparties for inclusion on the lending list.

10.5 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 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.

10.6 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.

10.7 The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

10.8 Investment instruments identified for use in the financial year are listed below under the 'Specified' and 'Non Specified' Investment categories.

10.9 The DCLG guidance requires authorities to specify their minimum acceptable credit rating. The minimum ratings required by the Council are:

Fitch

Long Term	Short Term	Individual	Support
A-	F2	bbb-	2

Moody's

Long Term	Short Term	Financial Strength
A3	P-2	C

S & P Long Term	Short Term
A-	A-3

11. CREDITWORTHINESS POLICY

11.1 This Council applies the creditworthiness service provided by Sector. This service employs a modelling approach utilising credit ratings from the three main credit rating agencies – Fitch, Moody's and Standard and Poors. The credit ratings of counterparties are supplemented with the following overlays.

- Credit watches and credit outlooks from credit rating agencies;
- Credit Default Spreads (CDS) to give early warning of likely changes in credit rating; and,
- Sovereign ratings to select counterparties from only the most creditworthy countries.

11.2 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.

Table 7 - Exposure limits and Duration

	Exposure limit £ million	Duration
Purple	25	2 years
Blue *	35	1 year
Orange	20	1 year
Red	20	6 months
Green	10	3 months
No Colour	0	not to be used

*only applies to nationalised or semi nationalised UK Banks

11.3 Their exceptions to this methodology include:

UK Government (no maximum amount)

- Debt Management Office
- Treasury Bills
- Government Gilts

Public Authorities (Exposure limit of £25 million with a maximum duration of 364 days)

- Unitary Authorities
- Local Authorities
- Borough and District Council's
- Met Police
- Fire and Police Authorities

These authorities do not have credit ratings but statute (LG Act 2003 s13) suggests that credit risk attached to these authorities is an acceptable one.

Money Market Funds

All funds have a AAA credit rating which have a 60 day weighted average maturity. These funds allow instant access to cash, and provide enhanced yield and security.

Exposure limit of £10 – no maximum duration as these are instant access funds.

11.4 Whilst the Council have adopted the Sector methodology for applying creditworthiness if any of the counterparties rating full below the Council's acceptable minimum credit rating (Para 10.9) they will be withdrawn immediately from the counterparty list.

11.5 The Council is alerted to changes to ratings of all three agencies through its use of Sector creditworthiness service.

- If a down grade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

- In addition to the use of credit ratings the Council will be advised of movements in Credit Default Swaps 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.

11.6 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 on government support for banks and the credit ratings of that government.

12. COUNTRY LIMITS

12.1 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA+ from Fitch Ratings (or equivalent from other agencies). The exposure limit to any one Country will be £20 million with the exception of the UK which will be unlimited.

13. INTEREST RATE OUTLOOK FOR INVESTMENTS

13.1 Bank Rate has been unchanged at 0.50% since March 2009. Bank rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 3 of 2013. Bank Rate forecasts for financial year ends (March) are as follows:-

2011/12	0.50%
2012/13	0.50%
2013/14	1.25%
2014/15	2.50%

13.2 There is downside risk 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.

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

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

13.4 For its cash flow generated balances, the Council will utilise its business reserve accounts, money market funds and short dates deposits (overnight to three months) in order to benefit from the compounding of interest.

13.5 Specified Investments

A specified investment is defined in the guidance as an investment which satisfies the conditions set out below:

(a) The investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling.
(b) The investment is not a long-term investment (i.e. over 364 days)
(c) The investment does not involve the acquisition of share capital or loan capital in any body corporate

Types of specified investments include and may be used by the Council are:

- Term deposit – UK government
- Term deposits – other Local Authorities
- Term deposits – banks and building societies
- Money market funds
- Callable deposits – under 1 year
- Certificates of deposits - issued by banks and building societies.
- UK Government Gilts
- Treasury Bills

13.6 Non-Specified Investments

If there was a core cash balance available after taking into account the cash flow requirements and the outlook for short–term interest rates then the following non-specified investments could be used after consultation with our Treasury Advisor.

- Term deposits with banks with maturities in excess of one year.
- Term deposits with building societies with maturities in excess of one year
- Term deposits with Local Authorities with maturities in excess of one year.
- Structured deposits.
- Bond Funds with AAA rating credit criteria
- Callable deposits in excess of one year
- Certificates of deposits - issued by banks and building societies in excess of one year.
- UK Government Gilts in excess of one year

14. CREDIT CRITERIA

14.1 The banking sector is still a volatile area and **the current policy is that whilst we maintain our full lending list in accordance with the methodology approved by Council on the 24 February 2010 we have been operating a more restricted lending list, lending only to UK banks, other Local Authorities and AAA Money Market Funds.** For illustrative purposes Appendix C is attached to show the countries and organisations on the lending list at the present time using the approved methodology.

14.2 The limits are driven by the methodology which is explained in paragraph11 above the maximum limits for these banks are shown in table 7. The limits can change if there are rating changes, however the maximum limit would never be more than £25 million except for the part nationalised banks which have a £35 million limit.

15. NATIONALISED BANKS AND PART NATIONALISED BANKS

15.1 In the UK, the nationalised and part-nationalised banks have credit ratings which do not conform to the credit criteria usually used to identify banks which are of high credit worthiness, as they are no longer separate institutions in their own right. However, the Council has agreed to invest in these institutions as they are now recipients of an F1 short term rating as they effectively take on the creditworthiness of the Government itself i.e. deposits made with them are effectively being made to the Government. They also have a support rating of 1; in other words, on both counts, they have the highest ratings possible.

16. HRA REFORM

16.1 The present HRA subsidy arrangements are to be replaced by a new self-financing regime under the Localism Act 2011 commencing on 1 April 2012. Under the revised arrangements local authorities are expected to become entirely self-sufficient, as a result of an adjustment to their debt position. The intention is that this will give authorities greater control and allow them to manage their housing stock over the longer term, rather than the current year-by-year basis.

16.2 The Department for Communities and Local Government (CLG) has produced a settlement valuation based on assumed levels of income and expenditure over the next 30 years. The settlement valuation is deemed to be supportable over the life of the 30 year business plan and CLG has demonstrated its sustainability by showing that debt could be fully repaid within the 30 years.

17 HRA SUBSIDY

17.1 At present Hammersmith and Fulham is in a positive subsidy position, whereby its assumed annual rental income is less than the assumed level of expenditure. This “shortfall” is met by the subsidy received from the Department for Communities and Local Government (CLG) which in itself is largely a redistribution of the surpluses from authorities in the reverse position.

17.2 Rather than receive subsidy in future Hammersmith and Fulham will receive a one off debt repayment of £196.8 million. No future subsidy will be receivable. The sum received is intended to create a sustainable HRA over a 30 year period.

17.3 The settlement date will be 28 March 2012. When the CLG repays the PWLB

£196.8 million, the PWLB will top slice all the existing PWLB loans in order to maintain both the average interest rate and the maturity profile of the loans. The Council's external debt will thus reduce from £459.5 million to £262.7 million. The General Fund CFR at 31 March 2012 is unaffected by the HRA reform and is estimated to be £112.7 million. The HRA CFR is estimated to be £218 million after moving to the new system.

18 IMPACT ON THE NET COST OF BORROWING

18.1 In the new system, local authorities will need to allocate existing and future borrowing costs between the HRA and the General Fund as the current statutory method of apportioning debt charges will cease. CLG has signalled its intention not to impose a single solution. CIPFA has set out a suggested methodology for splitting loans to meet the requirements of the new system, but has clearly stated that local authorities may pursue other methods which take account of the following recommended principles:

- The underlying principle for the splitting of loans, at transition, must be that of no detriment to the General Fund.
- Local authorities are required to deliver a solution that is broadly equitable between the HRA and the General Fund.
- Future charges to the HRA in relation to borrowing are not influenced by General Fund decisions, giving a greater degree of independence, certainly and control.
- Uninvested balance sheet resources which allow borrowing to be below the CFR are properly identified between General Fund and HRA.

18.2 There are two main options:

- Option A - all loans are pooled and the interest is then apportioned between the General Fund and the HRA according to their respective CFRs. This replicates the existing Consolidated Rate of Interest (CRI) calculation which takes account of both external borrowing and borrowing from internal cash balances but is based on the new lower debt figure.

- Option B – move to a separate HRA and General Fund debt pool. This is CIPFA's proposed solution. It would be assumed that all HRA debt is supported by external borrowing as historically the HRA balances were relatively low. The HRA would also be credited with the interest earned on HRA cash balances (including capital receipts).

18.3 Table 8 exemplifies the interest rate implications of these two options. The exemplifications need to be treated with caution. Assumptions are made about interest rates and levels of debt repayment that may well not transpire. Unapplied receipts may also be significantly less than modelled particularly for the decent neighbourhoods.

Table 8 – Interest Rate Exemplifications

18.4

	2012/13	2013/14	2014/15
General Fund	£'m	£'m	£'m
Option A	3.0	2.2	1.1
Option B	2.5	2.2	2.0
Housing Revenue Account			
Option A	11.5	11.8	11.8
Option B	12.0	11.8	10.9

The different options have markedly different outcomes. This is for several reasons but mainly:

- In initially moving to separate loan pools for the HRA and General Fund the interest rate charged to the HRA in 2012/13 would increase from 5.26% to 5.6%. This is because all HRA debt would be supported by external loans (at present there is an element of internal borrowing within the CRI calculation which has a lower rate).

- By 2014/15 this position would reverse. The HRA would start to benefit from the interest earned on receipts (decent neighbourhoods pot). In addition as debt falls out of the HRA it would see the full benefit of interest savings rather than a much smaller reduction in the CRI (less than 0.5%). There are loans totalling £12.1 million which are maturing over the three years 2012/13 to 2014/15 and are at interest rates of between 9% and 9.5% as they were taken out in the late 1980s.

- The rate charged under the CRI calculation to the HRA would also increase significantly in 2013/14. This is because the CFR would drop (due to debt redemption) below actual external debt. Thus the HRA would pick up the full (more expensive) external loans rate.

18.5 Compared to the current MTFS profile the anticipated savings from both option A and B would deliver General Fund underspends. Under option A the net underspend against budget would be £0.9m in 2012/13 increasing to £1.7m by 2014/15. Under option B the net underspend against budget would be £1.2m in 2012/13 reducing to £0.2m by 2014/15.

18.6 **It is recommended that option B – a separate loan pool for the HRA – is most consistent with the underlying principles stated in paragraph 18.1.** It would give the HRA greater certainty and control over its resources. An example as to how the CRI calculation as used by Option A can disadvantage the HRA is the sudden spike in the HRA charge in 2013/14. This has nothing to do with HRA decisions but is due to a greater level of General Fund debt redemption. This does not seem equitable.

18.7 Option B would potentially lower the potential benefits arising to the General Fund in the medium term. However MTFS targets would still be met. There may also be opportunities to increase the amount of debt savings through early settlement of loans. The Council can also revisit at a future point what calculation it uses as part of the annual Treasury Management Strategy.

18.8 It is recommended to move to a separate HRA and General Fund debt pool with effect from 1 April 2012. The HRA to receive investment income on unapplied HRA receipts and other HRA cash balances calculated at the average rate of interest earned on temporary investments.

19. INVESTMENT CONSULTANTS AND INVESTMENT TRAINING

19.1 Sector Treasury Services Ltd were appointed on 1 February 2011 for a three year period following a tendering exercise. Sector provide interest rate forecasts, economic updates, strategy reviews, training for treasury management staff and advice on the formulation of suitable borrowing and investment strategies and advice on investment counterparty creditworthiness.

19.2 The Council is a member of the CIPFA treasury management network which provides a forum for the exchange of views and training of treasury management staff independent of the treasury management consultants. It also provides a quality check on the services received from the consultants.

19.3 Treasury management staff are required to attend the CIPFA network meetings and Sector seminars and training events on a regular basis throughout the year to ensure that they are up to date at all times on developments in treasury management and continue to develop their expertise in this area.

20. COMMENTS OF THE EXECUTIVE DIRECTOR OF FINANCE AND CORPORATE GOVERNANCE

20.1 The comments of the Executive Director of Finance and Corporate Governance are contained within this report.

21. COMMENTS OF THE ASSISTANT DIRECTOR (LEGAL AND DEMOCRATIC SERVICES)

21.1 The statutory requirements are set out in the body of the report.

22. COMMENTS OF THE AUDIT AND PENSIONS COMMITTEE

22.1 Any comments from the Committee will be reported verbally at the meeting.

LOCAL GOVERNMENT ACT 2000
LIST OF BACKGROUND PAPERS

No.	Description of Background Papers	Name/Ext. of Holder of File/Copy	Department/ Location
1	Borrowings and Investments Ledger	Rosie Watson Ext. 2563	Ground Floor Town Hall
2	CIPFA-Prudential Code -Accounting for Capital Finance	Rosie Watson Ext. 2563	Ground Floor Town Hall

3	Various Economic commentaries	Rosie Watson Ext. 2563	Ground Floor Town Hall

APPENDIX A

THE TREASURY MANAGEMENT POLICY STATEMENT

CIPFA recommends that the Council's treasury management policy statement adopts the following form of words below to define the policies and objectives of its treasury management activities.

- This Council defines its Treasury Management activities as:
  The management of the Council'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.

- This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of Treasury Management activities will focus on their risk implications for the organisation, *and any financial instruments entered into to manage these risks.*

- This Council acknowledges that effective Treasury Management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

APPENDIX B

TREASURY MANAGEMENT PRACTICES

CIPFA recommends that the Council's treasury management practices (TMPs) include these of the following that are relevant to its treasury management powers and the scope of its treasury management activities:

TMP 1 Risk Management

General Statement
The responsible officer will design, implement and monitor all arrangements for the identification, management and control of treasury management risk, will report at least annually on the adequacy/suitability thereof, and will report, as a matter of urgency, the circumstances of any actual or likely difficulty in achieving the organisation's objectives in this respect, all in accordance with the procedures set out in TMP6 Reporting requirements and management information arrangements. In respect of each of the following risks, the arrangements which seek to ensure compliance with these objectives are set out in the schedule to this document.

i) **Credit and counterparty risk management**
This council regards a key objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, it will ensure that its counterparty lists and limits reflect a prudent attitude towards organisations with whom funds may be deposited, and will limit its investment activities to the instruments, method and techniques referred to in TMP 4 Approved instruments methods and techniques and listed in the schedule to this document. It also recognises the need to have, and will therefore maintain, a formal counterparty policy in respect of those organisations from which it may borrow, or with whom it may enter into other financial arrangements.

ii) **Liquidity risk management**
This council will ensure it has adequate though not excessive cash resources, borrowing arrangements, overdraft or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives.

This council will only borrow in advance of need where there is a clear business case for doing so and will only do so for the current capital programme or to finance future debt maturities.

iii) **Interest rate risk management**
This council will manage its exposure to fluctuations in interest rates with a view to containing its interest costs, or securing its interest revenues, in accordance with the amounts provided in its budgetary arrangements as amended in accordance with TMP 6 Reporting requirement and management information arrangements.

It will achieve this by the prudent use of its approved financing and investment instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates. This should be subject to the consideration and, if required, approval of any policy or budgetary implications.

It will ensure that any hedging tools such as derivatives are only used for the management of risk and the prudent management of financial affairs and that the policy for the use of derivatives is clearly detailed in the annual strategy.

iv) Exchange rate risk management

It will manage its exposure to fluctuations in exchange rates so as to minimise any detrimental impact on its budgeted income/expenditure levels.

v) Refinancing risk management

This council will ensure that its borrowing, private financing and partnership arrangements are negotiated, structured and documented, and the maturity profile of the monies so raised are managed, with a view to obtaining offer terms for renewal or refinancing, if required, which are competitive and as favourable to the council as can reasonably be achieved in the light of market conditions prevailing at the time.

It will actively manage its relationships with its counterparties in these transactions in such a manner as to secure this objective, and will avoid over- reliance on any one source of funding if this might jeopardise achievement of the above.

vi) Legal and regulatory risk management

This council will ensure that all its treasury management activities comply with its statutory powers and regulatory requirements. It will demonstrate such compliance, if required to do so, to all parties with whom it deals in such activities. In framing its credit and counterparty policy under TMP 1 (i) Credit and counterparty risk management, it will ensure that there is evidence of counterparties' powers, authority and compliance in respect of the transactions they may effect with the council, particularly with regard to duty of care and fees charged.

This council recognises that future legislative or regulatory changes may impact on its treasury management activities and, so far as it is reasonably able to do so, will seek to minimise the risk of these impacting adversely on the organisation.

vii) Fraud, error and corruption, and contingency management

This council will ensure that it has identified the circumstances which may expose it to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings. Accordingly, it will employ suitable systems and procedures, and will maintain effective contingency management arrangements, to these ends.

viii) Market risk management

This council will seek to ensure that its stated treasury management policies and objectives will not be compromised by adverse market fluctuations in the value of the principal sums it invests, and will accordingly seek to protect itself from the effects of such fluctuations.

TMP 2 Performance measurement

This council is committed to the pursuit of value for money in its treasury management activities, and to the use of performance methodology in support of that aim, within the framework set out in its treasury management policy statement.

According, the treasury management function will be the subject of ongoing analysis of the value it adds in support of the council's stated business or service objectives. It will be the subject of regular examination of alternative methods of service delivery, of the availability of fiscal or other grant or subsidy incentives, and of the scope for other potential improvements. The performance of the treasury management function will be measured using the criteria set out in the schedule to this document.

TMP 3 Decision-making and analysis

This council will maintain full records of its treasury management decisions, and of the processes and practices applied in reaching those decisions, both for the purposes of learning from the past, and for demonstrating that reasonable steps were taken to ensure that all issues relevant to those decisions were taken into account at that time. The issues to be addressed and processes and practices to be pursued in reaching decisions are detailed in the schedule to this document.

TMP 4 Approved Instruments, method and techniques

This council will undertake its treasury management activities by employing only those instruments, methods and techniques detailed in the schedule to this document, and within the limits and parameters defined in TMP1 Risk management.

Where this council intends to use derivative instruments for the management of risks, these will be limited to those set out in its annual strategy. The organisation will seek proper advice and will consider that advice when entering into arrangements to use such products to ensure that it fully understands those products.

TMP 5 Organisation, clarity and segregation of responsibilities, and dealing arrangements

This council considers it essential, for the purposes of the effective control and monitoring of its treasury management activities, for the reduction of the risk of fraud or error, and for the pursuit of optimum performance, that these activities are structured and managed in a fully integrated manner, and that there is at all times a clarity of treasury management responsibilities.

The principal on which this will be based is a clear distinction between those charged with setting treasury management policies and those charged with implementing and controlling these policies, particularly with regard to the execution and transmission of funds, the recording and administering of treasury management decisions, and the audit and review of the treasury management function.

If and when this council intends, as a result of lack of resources or other circumstances, to depart from these principles, the responsible officer will ensure that the reasons are properly reported in accordance with TMP 6

Reporting requirements and management information arrangements, and the implications properly considered and evaluated.

The responsible officer will ensure that there are clear written statements of the responsibilities for each post engaged in treasury management, and the arrangements for absence cover. The responsible officer will also ensure that at all times those engaged in treasury management will follow the policies and procedures set out. The present arrangements are detailed in the schedule to this document.

The responsible officer will ensure there is proper documentation for all deals and transactions, and that procedures exist for the effective transmission of funds. The present arrangements are detailed in the schedule to this document.

The delegations to the responsible officer in respect of treasury management are set out in the schedule to this document. The responsible officer will fulfil all such responsibilities in accordance with the council's policy statement and TMPs and, if a CIPFA member, the Standard of Professional Practice on Treasury Management.

TMP 6 Reporting requirements and management information arrangements

This council will ensure that regular reports are prepared and considered on the implementation of its treasury management policies; on the effect of decisions taken and transactions executed in pursuit of those policies; on the implications of changes, particularly budgetary, resulting from regulatory, economic, market or other factors affecting its treasury management activities; and on the performance of the treasury management function.

As a minimum:

The council will receive:

- An annual report on the strategy and plan to be pursued in the coming year.
- A mid-year review.
- An annual report on the performance of the treasury management function, on the effects of the decisions taken and the transactions executed in the past year, and on any circumstances of non-compliance with the council's treasury management policy statement and TMPs.

The Cabinet will receive regular monitoring reports on treasury management activities and risks.

The body responsible for scrutiny, such as audit or scrutiny committee, will have responsibility for the scrutiny of treasury management policies and practices.

The Council will report the treasury management indicators as detailed in the sector specific guidance notes.

The present arrangements and the form of these reports are detailed in the schedule to this document.

TMP 7 Budgeting, accounting and audit arrangements

The responsible officer will prepare, and this council will approve and, if necessary, from time to time will amend, an annual budget for treasury management, which will bring together all of the costs involved in running the treasury management function, together with associated income. The matters to be included in the budget will at minimum be those required by statute or regulation, together with such information as will demonstrate compliance with TMP1 Risk Management, TMP 2 Performance measurement, and TMP 4 Approved instruments, methods and techniques. The responsible officer will exercise effective controls over this budget, and will report upon and recommend any changes required in accordance with TMP 6 Reporting requirements and management information arrangements.

This council will account for its treasury management activities, for decisions made and transactions executed, in accordance with appropriate accounting practices and standards, and with statutory and regulatory requirements in force for the time being.

TMP 8 Cash and cash flow management

Unless statutory or regulatory requirements demand otherwise, all monies in the hands of this council will be under the control of the responsible officer, and will be aggregated for cash flow and investment management purposes. Cash flow projections will be prepared on a regular and timely basis, and the responsible officer will ensure that these are adequate for the purposes of monitoring compliance with TMP 1 Liquidity risk management. The present arrangements for preparing cash flow projections, and their form, are set out in the schedule to this document.

TMP 9 Money laundering

This council is alert to the possibility that it may become the subject of an attempt to involve it in a transaction involving the laundering of money. Accordingly, it will maintain procedures for verifying and recording the identity of counterparties and reporting suspicions, and will ensure that staff involved in this are properly trained. The present arrangements, including the name of the officer to whom reports should be made, are detailed in the schedule to this document.

TMP10 Training and qualifications

This council recognises that the importance of ensuring that all staff involved in the treasury management functions are fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to appoint individuals who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills. The responsible officer will recommend and implement the necessary arrangements.

The responsible officer will ensure that Council members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and responsibilities.

Those charged with governance recognise their individual responsibility to ensure that they have the necessary skills to complete their role effectively.

The present arrangements are detailed in the schedule to this document.

TMP11 Use of external providers

This council recognises that responsibility for treasury management decisions remains with the council at all times. It recognises that there may be potential value in employing external providers of treasury management services, in order to acquire access to specialist skills and resources. When it employs such services providers, it will ensure it does so for reasons which have been submitted to a full evaluation of the costs and benefits. It will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subject to regular review. And it will ensure, where feasible and necessary, that a spread of service providers, is used, to avoid over reliance on one or a small number of companies. Where services are subject to formal tender or re-tender arrangements, legislative requirements will always be observed. The monitoring of such arrangements rest with the responsible officer, and details of the current arrangements are set out in the schedule to this document.

TMP12 Corporate governance

This council is committed to the pursuit of proper corporate governance throughout its businesses and services, and to establishing the principles and practices by which this can be achieved. Accordingly, the treasury management function and its activities will be undertaken with openness and transparency, honesty, integrity and accountability.

This council has adopted and has implemented the key principles of the Code. This together with the other arrangements detailed in the schedule to this document, are considered vital to the achievement of proper corporate governance in treasury management, and the responsible officer will monitor and, if and when necessary, report upon the effectiveness of these arrangements.