London Borough of Hammersmith & Fulham

Cabinet

8 FEBRUARY 2010

LEADER
Councillor Stephen Greenhalgh

TREASURY MANAGEMENT STRATEGY REPORT

Wards

All

This report explains that CIPFA has published a new Treasury Management Code of Practice and seeks formal adoption of the new Code.

In addition the report provides information on the Council's Treasury Management Strategy for 2010/11 including interest rate projections and borrowing and investment activity reports for the period April to November 2009.

The report seeks approval for borrowing limits and authorisation for the Director of Finance & Corporate Services to arrange the Council's cashflow, borrowing and investments in the year 2010/11.

CONTRIBUTORS

DFCS
ADLDS

HAS A PEIA BEEN COMPLETED? YES

Recommendations:

1. **To adopt the new CIPFA's Treasury Management in the Public Services Code of Practice, with effect from 1st April 2010.**

2. **To adopt the Treasury Management Policy Statement and clauses as per paragraphs 2 and 3 of the report.**

3. **To approve the future borrowing and investment strategies.**

4. **In relation to the Council's overall borrowing for the financial year 2010/11, approve the Prudential Indicators as set out in Section 3 of this report.**

5. **To approved the methodology for establishing credit criteria.**

6. **To delegate future amendments to the credit criteria methodology to Cabinet.**

1. INTRODUCTION

1.1. A revised CIPFA Code of Practice on Treasury Management in the Public Services and guidance notes were published in November 2009. The Local Authorities (Capital Finance and Accounting) Regulations 2003 require authorities to "have regard" to code and guidance notes. The Council is required to formally adopt the revised Code of Practice and the treasury management policy statement as set out in paragraph 2 and clauses as set out in paragraph 3 below. The principal reasons for revising the code were that CIPFA has:

- Published a revised Prudential Code for Capital Finance in Local Authorities (the Prudential Code)
- Adopted the principles of International Financial Reporting Standards for Financial Instruments
- Responded to the Icelandic bank crisis, including providing evidence at the Select Committee into local authority investments.

1.2. The financial markets have experienced a period of considerable turmoil during the 'credit crunch' starting in 2008, focusing attention on a wide range of treasury management practices but, in particular, the assessment of the credit standing of counterparties with whom local authorities transact their treasury business. National reports have been produced by the Audit Commission and the Communities and Local Government Select Committee which have made recommendations that certain elements of the Treasury Management Code and guidance notes be reviewed.

1.3. The Department for Communities and Local Government published a consultation paper in November 2009 on proposed changes to the CLG investments guidance which, subject to the outcome of the consultation, will come into effect on 1st April 2010.

1.4. The Local Government Act 2003 requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy; which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

1.5. The suggested strategy for 2010/11 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;
- the borrowing requirements;
- prospects for interest rates;
- the borrowing strategy;
- the investment strategy;
- debt rescheduling;

1.6. It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from:-

a) increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
b) any increases in running costs from new capital projects are limited to a level which is affordable within the projected revenue income of the Council for the foreseeable future.

2. THE TREASURY MANAGEMENT POLICY STATEMENT

2.1. 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.

- 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.

3. CLAUSES TO BE FORMALLY ADOPTED

CIPFA recommends that public service organisations adopt the following four clauses:

3.1 This Council will create and maintain, as the cornerstones for effective treasury management:

- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities.

- Suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The content of the policy statement and TMPs will follow the recommendations of the Code subject only to amendments where necessary to reflect the particular circumstances of the Council. Such amendments will not result in the Council materially deviating from the Code's key principles.

3.2 This Council will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.

3.3 This Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and for the execution and administration of treasury management decisions to the Director of Finance and Corporate Services, who will act in accordance with the Council's policy statement and TMPs and CIPFA's Standard of Professional Practice on Treasury Management.

3.4 This Council nominates audit committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

4. TREASURY MANAGEMENT PRACTICES

The new code has revised the guidance notes for the Treasury Management Practices. They are attached in full as Appendix A. Behind the Treasury Management Practices are supporting schedules and details of the systems and routines to be employed and the records to be maintained. These will be updated to reflect the changes in the Code of Practice.

5. TREASURY LIMITS 2009/10 TO 2011/12

It is a statutory duty under S.3 of the Local Government Act 2003 and supporting regulations for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Authorised Limit".

The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is 'acceptable'.

Whilst termed an "Authorised Limit", the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and the two successive financial years.

5.1 Limits to Borrowing Activity

a) The Authorised Limit – This represents the maximum amount the Council may borrow at any point in time in the year. It has to be set at a level the Council considers "prudent" and it needs to be set and revised by members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable and encompasses borrowing for temporary purposes. It is not a limit that is designed to be brought into consideration during the routine financial management of the authority. That is the purpose of the Operational Boundary.

b) 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 authority 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 has set itself.

5.2 Interest Rate Exposures

Interest rate risk management is a top priority for local authority management. While fixed rate borrowing and investment can contribute significantly to reducing the uncertainty surrounding future interest rate scenarios, the pursuit of optimum performance may justify, or even demand, retaining a degree of flexibility through the use of variable interest rates on at least part of a treasury management portfolio. This is a best practice approach to treasury management and is to be encouraged to the extent that it is compatible with the effective management and control of risk.

a) Upper Limit on fixed rate exposure -– This indicator identifies a maximum limit for fixed interest rates based upon the debt position net of investments.

b) Upper Limit on variable rate exposure – This indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments.

c) Total principal funds invested for periods longer that 364 days – These limits are set to reduce the need for early sale of an investment, and are based on the availability of investments after each year-end.

d) Maturity structures of borrowing – This indicator is designed to be a control over an authority having large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates. It is not necessary to include variable rate debt because local authorities do not face substantial refinancing risks. The indicator is, in effect, a limit on longer term interest rate exposure.

- This indicator gives the upper and lower limits for maturity structure of borrowing.

6. PRUDENTIAL INDICATORS FOR 2009/10 – 20012/13

The Prudential Indicators in the table below are relevant for the purpose of setting an integrated treasury management strategy.
The Council is also required to indicate if it has adopted the revised 2009 CIPFA Code of Practice on Treasury Management.

Treasury Management Indicators	**2009/10 £000**	**2010/11 £000**	**2011/12 £000**	**2012/13 £000**
Authorised limit for external debt				
Borrowing	506,991	570,171	573,144	575,829
Other Long Term Liabilities	0	0	0	0
Total authorised limit	506,991	570,171	573,144	575,829
Operational boundary				
Borrowing	490,450	506,275	512,555	534,755
Other Long Term Liabilities	0	0	0	0
Total operational boundary	490,450	506,275	512,555	534,755
Upper limit for fixed rate exposure expressed as :- net principal re fixed rate borrowing/ investments	493,000	540,000	547,000	555,000
Upper limit for variable rate exposure expressed as :- net principal re variable rate borrowing /investments	98,000	108,000	109,400	110,000
Upper limit for total principal sums invested for over 364 days	20,000	20,000	20,000	20,000

Maturity structure of fixed rate borrowing during 2010/11	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%

7. CURRENT PORTFOLIO POSITION

7.1 The Council's treasury portfolio position at the 30 November 2009 is shown in the following table.

		Principal		Ave. rate
		£000's	£000's	%
Fixed rate funding	PWLB	475,520		
	Market	0	475,520	5.93
Variable rate funding	PWLB	0		
	Market	0	0	
Total Debt			475,520	5.93
Total Short Term Investments			145,850	1.39
Total Debt net of total Investments			329,670	

7.2 The reason for the difference between the gross and net debt is because the Council has borrowed £77 million for the Decent Homes Initiative and expects this to be used by 31st March 2010. In addition, the Council is holding monies on behalf of Capital Ambition, West London Housing in addition to Section 106 planning money.

8. BORROWING REQUIREMENT

	2009/10 £'000	2010/11 £'000	2011/12 £'000	2012/13 £'000
	Actual	Estimate	Estimate	Estimate
New borrowing (including ALMO)	77,000	10,800	22,200 *	6,200

*Note: this includes £16 million of replacement borrowing for maturing loans

8.1 Under the capital finance regulations, local authorities are permitted to borrow up to three years in advance of need. This Council will only consider borrowing up to 1 year in advance of need as the borrowing requirement in later years is only an estimate at this stage. The reason for borrowing in advance is to take advantage of low long term interest rates. There is a short term cost to borrowing in advance of need as currently investment rates are considerably lower than long term borrowing rates. This will be evaluated before any decision is taken to borrow in advance of need.

8.2 Borrowing in advance of need increases the level of temporary investments and thus increases the risk of loss of investment principal. However, the

Council has put in place a prudent methodology to minimise this risk, see paragraph 13.

9. PROSPECTS FOR INTEREST RATES

9.1 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. Appendix B draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Sector central view:

9.2 Sector Bank Rate forecast for financial year ends (March)

2010 0.50%
2011 1.50%
2012 3.50%
2013 4.50%

There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected.

10. BORROWING STRATEGY

	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Mar-12	Mar-13
Bank rate	0.50%	0.50%	0.50%	0.75%	1.00%	1.50%	3.50%	4.50%
5yr PWLB rate	2.85%	3.05%	3.20%	3.30%	3.40%	3.60%	4.60%	4.85%
10yr PWLB rate	3.90%	4.00%	4.05%	4.15%	4.30%	4.45%	5.00%	5.15%
25yr PWLB rate	4.40%	4.55%	4.65%	4.70%	4.80%	4.90%	5.20%	5.35%
50yr PWLB rate	4.45%	4.60%	4.70%	4.75%	4.90%	5.00%	5.30%	5.45%

In view of the above forecast the Council's borrowing strategy will be based upon the following information.

10.1 Rates are expected to gradually increase during the year, so it should therefore be advantageous to time new long term borrowing for the start of the year. However, a cautious approach is adopted to any borrowing in advance of need as this increases the security risk of investments.

10.2 Under 10 year PWLB rates are expected to be substantially lower than longer term PWLB rates offering a range of options for new borrowing which will spread debt maturities away from a concentration in long dated debt.

10.3 There is expected to be little difference between 25 year and 50 year rates thus loans in the 25-30 year periods could be seen as being more attractive than 50 year borrowing as the spread between the PWLB new borrowing and early repayment rates is considerably less. This would maximise the potential for debt rescheduling and allow the Council to rebalance its debt maturity profile.

10.4 **Sensitivity of the forecast –** In normal times the main sensitivities of the forecast are likely to be the two scenarios below. Treasury officers, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

- If it were felt that there was a significant risk of a sharp fall in long and short term rates, due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowing will be postponed.

- If it were felt that there was a significant risk of a sharp rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

11. ANNUAL INVESTMENT STRATEGY

11.1 The Council is required to have regard to the CLG's Guidance on Local Government Investments ("the Guidance") issued in March 2004. and the 2009 CIPFA's Treasury Management in Public Services of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). This strategy also takes into account proposed changes to the CLG's guidance as set out in the consultation paper published in November 2009. The investment strategy has to be approved by full Council, but it is proposed that amendments to the investment methodology will be delegated to Cabinet to enable changes to be made on a timely basis to reflect changes in market conditions.

11.2 The Council's investments priorities are:-

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

Provided that proper levels of security and liquidity are achieved the Council will then aim to achieve the optimum return on its investments consistent with these priorities.

11.3 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.

11.4. Investment instruments identified for use in the financial year are listed below under the ‘Specified’ and ‘Non Specified’ Investment categories. Counterparty limits will be as set by Council.

11.5 The Council in conjunction with its treasury advisor Sector, will use Fitch, Moody’s and Standard and Poor ratings plus data on movements in credit default swap to derive its credit criteria. Credit ratings alerts and changes are notified to treasury officers on a daily basis and these are acted upon immediately. In addition officers monitor the financial press and economic reports. 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.

- In addition to the use of Credit Rating the Council will be advised of information in movements in Credit Default Swaps (CDSs) 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 Councils lending list. It should be noted that the Council is only monitoring CDS movements for information purposes, and is not actually purchasing any CDSs.

11.6 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	C	2

Moody’s

Long Term	Short Term	Financial Strength
A3	P-2	C

S & P

Long Term	Short Term
A-	A-3

12. INTEREST RATE OUTLOOK FOR INVESTMENTS

Bank Rate has been unchanged at 0.50% since March 2009. Bank rate is forecast to commence rising in quarter 3 of 2010 and then to rise steadily from thereon. Bank Rate forecasts for financial year ends (March) are as follows:-

2010	0.50%
2011	1.50%
2012	3.50%
2013	4.50%

There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected.

The Council will avoid locking into longer term deals while investment rates are down at historically low levels unless exceptionally attractive rates are available which make longer term deals worthwhile.

The Council will report on its investment activity as part of a mid year review and at the end of the financial year as part of the Annual Outturn Report.

12.1 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 (ie 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

12.2 Non-Specified Investments

The Council has made no investments in non-specified investments to date. These are any investments not meeting the definition in para 12.1 above.

12.3 However 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

13. METHODOLOGY FOR ESTABLISHING CREDIT CRITERIA

13.1 Each month the Treasury Section receives an up to date list of the credit rating for individual counterparties from our treasury advisors. In addition to this if any changes in the credit rating of individual counterparties or in banking structures e.g. on mergers or takeovers occur during the month Sector e-mail the amendments to the Treasury Section on a daily basis and the section adds/deletes counterparties as appropriate to/from the approved counterparty list.

13.2 The banking sector is still a volatile area and the current policy is that whilst we maintain our lending list in accordance with the methodology in Appendix C. we are continuing to operate a more restricted lending list. For illustrative purposes Appendix D is attached to show the countries and organisations on the lending list at the present time using this methodology. This means that organisations will be added to and removed from the lending list during the year depending on changes to the ratings.

13.3 **Nationalised Banks and Part Nationalised Bank** in the UK have credit ratings which do not conform to the credit criteria usually used to identify banks which are of high credit worthiness. In particular, as they are no longer separate institutions in their own right, it is impossible for Fitch to assign them an individual rating for their stand alone financial strength. Accordingly, they have been assigned an F rating which means that at a historical point of time, they have failed and are now owned by the Government or E rating which means it requires external support and is part owned by the Government.

However it should be noted that the individual rating is only one component of Fitch's rating. These institutions 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.

It should also be noted that in December 2009 the individual ratings on both the Lloyds Banking Group and The Royal of Scotland Group have been upgraded by Fitch from E to C and E to D/E respectively whilst still part nationalised. This reflects Fitch's view that there have been improvements in the groups' capital combined with some progress in restructuring their balance sheet.

14. DEBT RESCHEDULING

14.1 The introduction of different PWLB rates on 1st November 2007 that introduced a spread between the rates applied to new borrowing and repayment of debt, has meant that PWLB to PWLB debt restructuring is now much less attractive than before that date.

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

- The generation of cash savings and / or discounted cash flow savings
- Help fulfil the strategy outlined in paragraph 10 above; and

- Enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

15. HAMMERSMITH & FULHAM HOUSING MANAGEMENT SERVICES (HFHMS)

H& F Homes submitted a bid in 2005/06 for £192 million to the DCLG for supported borrowing for the Decent Homes Initiative. This funding has been drawn down since 2005/06 but for 2009/10 there was a borrowing requirement of £77 million and this borrowing was taken in November 2009. This borrowing will be supported through Housing Revenue Account Subsidy. There is a further borrowing requirement for the Decent Homes Initiative of £4.7 million in 2010/11.

16. INVESTMENT CONSULTANTS AND INVESTMENT TRAINING

16.1 Sector Treasury Services Ltd were appointed on 1st February 2009 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.

16.2 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.

16.3 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.

17. COMMENTS OF THE DIRECTOR OF FINANCE AND CORPORATE SERVICES

17.1 The comments of the Director of Finance are contained within this report.

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

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

19. COMMENTS OF THE VALUE FOR MONEY SCRUTINY COMMITTEE

19.1 Verbal comments from the Value for Money Scrutiny Committee will be reported at the Cabinet 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

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.

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.

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.*

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 be observed. The monitoring of such arrangements rests 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.

Appendix B Interest Rate Forecasts

The data below shows a variety of forecasts published by a number of institutions. The first three are individual forecasts including those of UBS and Capital Economics (an independent forecasting consultancy). The final one represents summarised figures drawn from the population of all major City banks and academic institutions.

The forecast within this strategy statement has been drawn from these diverse sources and officers' own views.

1. INDIVIDUAL FORECASTS

Sector interest rate forecast – 23.11.09

	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
Bank rate	0.50%	0.50%	0.50%	0.75%	1.00%	1.50%	2.25%	2.75%	3.25%	3.50%	3.75%	4.25%	4.25%	4.50%
5yr PWLB rate	2.85%	3.05%	3.20%	3.30%	3.40%	3.60%	3.85%	4.15%	4.55%	4.60%	4.80%	4.80%	4.85%	4.85%
10yr PWLB rate	3.90%	4.00%	4.05%	4.15%	4.30%	4.45%	4.60%	4.80%	4.90%	5.00%	5.10%	5.10%	5.15%	5.15%
25yr PWLB rate	4.40%	4.55%	4.65%	4.70%	4.80%	4.90%	5.00%	5.05%	5.10%	5.20%	5.30%	5.30%	5.35%	5.35%
50yr PWLB rate	4.45%	4.60%	4.70%	4.75%	4.90%	5.00%	5.10%	5.15%	5.20%	5.30%	5.40%	5.40%	5.45%	5.45%

Capital Economics interest rate forecast – 5.11.09

	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
5yr PWLB rate	2.85%	2.65%	2.15%	2.15%	2.15%	2.15%	2.15%	2.15%	2.15%
10yr PWLB rate	3.75%	3.15%	2.65%	2.65%	2.65%	2.65%	2.65%	2.65%	2.65%
25yr PWLB rate	4.25%	3.95%	3.75%	3.75%	3.75%	3.75%	3.75%	3.75%	3.75%
50yr PWLB rate	4.35%	4.15%	4.05%	4.05%	4.05%	4.05%	4.05%	4.05%	4.05%

UBS interest rate forecast (for quarter ends) – 30.10.09

	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
Bank Rate	0.50%	0.50%	0.50%	0.75%	1.00%	1.50%	2.00%	2.50%	3.00%
10yr PWLB rate	3.75%	3.90%	4.05%	4.40%	4.75%	4.90%	5.15%	5.40%	5.40%
25yr PWLB rate	4.40%	4.45%	4.65%	5.00%	5.15%	5.40%	5.65%	5.90%	5.90%
50yr PWLB rate	4.50%	4.55%	4.75%	5.10%	5.25%	5.50%	5.75%	6.00%	6.00%

2. SURVEY OF ECONOMIC FORECASTS

HM Treasury – summary of forecasts of 23 City and 12 academic analysts for Q4 2009 and 2010 published in November 2009. Forecasts for 2010 – 2013 are based on 21 forecasts in the last quarterly forecast – November 2009.

BANK RATE FORECASTS		quarter ended		annual average Bank Rate			
	actual	Q4 2009	Q4 2010	ave. 2010	ave. 2011	ave. 2012	ave. 2013
Median	0.50%	0.50%	1.30%	0.70%	1.80%	3.00%	3.70%
Highest	0.50%	0.50%	2.30%	1.30%	3.30%	4.30%	4.60%
Lowest	0.50%	0.50%	0.50%	0.50%	0.50%	1.00%	1.40%

APPENDIX C

METHODOLOGY FOR ESTABLISHING CREDIT CRITERIA

The follow methodology has been used to establish the credit criteria for an organisation or group.

All Countries where investments are placed should have a minimum **Sovereign rating** of AA+

The Council will use all 3 credit rating agencies Fitch, Moody's and Standard & Poor to derive its credit criteria. The methodology has a mathematical basis and gives a score to each of the ratings. An average score is then calculated for each of the constituent rating for Long Term, Short Term, Individual and Support. A sum of the averages is then taken and duration calculated based on this final value. The methodology is completely objective and mathematical, applying equal weight to each credit rating component.

The system also takes into account negative and positive rating watches and outlook.

The methodology applies a ranking and scoring procedure to the credit rating to obtain a number, based on all the credit ratings of every rating agency, which is then compared to the scoring bands.

Scoring procedure for the 3 Credit Rating Agencies

Long Term Ratings

Fitch		Moody's		S&P	
Rating	**Scoring**	**Rating**	**Scoring**	**Rating**	**Scoring**
AAA	1	Aaa	1	AAA	1
AA+	2	Aa1	2	AA+	2
AA	3	Aa2	3	AA	3
AA-	4	Aa3	4	AA-	4
A+	5	A1	5	A+	5
A	6	A2	6	A	6
A-	7	A3	7	A-	7

Short Term Ratings

Fitch		Moody's		S&P	
Rating	**Scoring**	**Rating**	**Scoring**	**Rating**	**Scoring**
F1+	1	-	-	A-1+	1
F1	2	P-1	2	A-1	2
F2	3	P-2	3	A-3	3

Only Fitch and Moody's use Individual Ratings

Individual Ratings

Fitch		Moody's	
Rating	**Scoring**	**Rating**	**Scoring**
-	-	A+	0.5
A	1	A	1
-	-	A-	1.5
A/B	2	B+	2
B	3	B	3
-	-	B-	3.5
B/C	4	C+	4
C	5	C	5

Support Ratings
As only Fitch uses Support ratings, there is no need to create any equivalency tables and we can use the rating directly into the calculation.

We then calculate the scoring for each counterparty on the scoring procedure.

Example

	Fitch				Moody's			S&P	
	Long Term	Short Term	Indiv	Suppor t	Long Term	Short Term	FRS	Long Term	Short Term
Bank									
Austrialia and New Zealand Banking Group	AA-	F1+	B	1	Aa1	P-1	B	AA	A-1+
Scoring	4	1	3	1	2	2	3	3	1

The Average for Long Term Rating is Fitch 4, Moody's 2 and S&P 3 = 9
9 divided by 3 (the no. of agencies) = 3

The Average for Short Term Rating is Fitch 1, Moody's 2 and S&P 1 = 4
4 divided by 3 (the no. of agencies) = 1.333

The Average for Individual Rating is Fitch 3 and Moody's 3 = 6
6 divided by 2 (the no. of agencies) = 3

The average for Support Rating is Fitch 1 as it is the only agency that uses Support Ratings

The sum total of these averages = 3+1.333+3+1 = 8.333

The score is now placed within the predetermined bands.

Bands

Colour	Lower Boundary	Upper Boundary
Purple	4.00	8.50
Orange	8.50	10.50
Red	10.50	12.50
Green	12.50	14.50
No Colour	14.50	30.00

Where:-
Purple - Exposure limit of £25 Million with a maximum duration of 24 months.
Orange - Exposure limit of £25 Million with a maximum duration of 364 days.
Red – Exposure limit of £20 Million with a maximum duration of 6 months.
Green – Exposure limit of £10 Million with a maximum duration of 3 months
No Colour – 0 months duration

In the example a score of 8.33 would place the bank in the Purple band and gives it a suggested maximum duration of 24 months.

Credit Watch/Outlook Overlay

To take into account credit watch and outlooks from the three credit rating agencies an overlay has been developed which penalises a counterparty's score.

The methodology focuses just on the negative and positive outlooks and watches. Although stable, evolving and developing outlooks are still considered important when looking for a broader credit perspective, they can not be correlated with a direct impact in the change of counterparties score on the credit list.

Watches – are considered short term actions, where as **outlooks** are considered over a longer period of time.

To take account of the effect of a bank being on **negative watch**, one point is added to the score of the relevant credit rating e.g. if Moody's placed a bank's short term rating on negative watch, we would add one point to its score. The opposite is applied for positive watches, 1 point is deducted.

To take account of the effect of a bank being on **negative outlook**, then 1/2 point is added to the score of the relevant credit rating e.g. if Moody's placed a bank's short term rating on negative outlook, we would add 1/2 point to its score. The opposite is applied for positive outlooks, 1/2 point is deducted.

In the example above for Australia and New Zealand Group if Fitch had placed the bank on negative watch we would have added one point to the Fitch Long Term score to penalise the bank

The Average for Long Term Rating is Fitch 4 +1, Moody's 2 and S&P 3 = 9
9 divided by 3 (the no. of agencies) = 3.333

Then when the sum total had been added together it would have changed from 8.333 to 8.666 which would move it down to a lower band – Orange.

Banks that do not have a four way credit rating

To account for banks that do not have a full 4 way credit rating i.e. Long Term, Short Term, Individual and Support ,adjustments will be made to that bank's score.

By not having a full set of ratings it can skew the score for a bank making it higher as only 2 or 3 variables are being taken into account. See example below.

Example

	Fitch				Moody's			S&P	
	Long Term	Short Term	Indiv	Support	Long Term	Short Term	FRS	Long Term	Short Term
Bank									
Jyske Bank					Aa2	P-1	B-		
Scoring					4	2	3.5		

The average score is going to be:-

Long Term - 4, Short Term – 2, Individual 3.5, Support – 0 = 9.5

As this bank is only rated by Moody's and therefore does not have a four way approach. Currently they have a score of 9.5 putting them into the Orange band.

This colour of Orange is biased upwards as only 3 ratings have been taken into account, so it is intended to drop the colour of the bank by one band for every missing rating.

So if an bank only had a Long and Short Term rating, the initial colour would be reduced by 2 bands.

Applying CDS spreads to the credit list

CDS spreads are used as it has been proven that credit rating agencies lag market events and thus do not provide investors with an "up to date" picture of the credit quality of a particular bank.

CDS spreads are used as an overlay to the credit ratings. CDS spreads provide perceived market sentiment regarding the credit quality of an institution. Since they are traded instruments, they reflect the market perception related to that entity's credit quality. Credit ratings look at a firm's fundamentals i.e. balance sheet, income statement etc. and tend to focus on a longer term view of the firm.

It is important to note that not all entities will have an actively traded CDS spread.

Trend analysis

The weekly credit list provided by Sector shows the 1 week, 1 month and 3 month percentage change in a counterparty's CDS spread. This allows Treasury officers to monitor the short, medium and long term trends of CDS spreads.

Benchmark analysis

The benchmark CDS index which measures the "average" level of the most liquid financial CDS spreads in the market is the iTraxx Senior Financials Index. This is an index published by Markit who are the leading company in CDS pricing and valuation. The index is based on an equal weighting of CDS spreads of 25 European financial companies.

The iTraxx can be used to see where an institution's CDS spread is relative to that of the market and judge its creditworthiness in that manner, as well as looking at the credit rating.

Adjusted duration

The methodology employs the rule that if the CDS spread of a bank/building society is below or equal to the level of the iTraxx, then it is deemed "In Range." It retains its' colour and duration.

If the bank/building society's CDS spread is between the iTraxx level and the iTraxx level + 50bps, then it is deemed "Monitoring." When a bank/building society is "Monitoring" its colour and duration is reduced by one band.

If the bank/building society's CDS spread is above the iTraxx level + 50bps, then it is deemed "Out of Range" its colour becomes no colour and is removed from the list.

Exceptions to this methodology

Nationalised and Part Nationalised Banks

See paragraph 13.3

In light of this the colour Blue is used, for UK nationalised or part nationalised banks
Exposure limit of £35 Million with a maximum duration of 364 days.

Government

Debt Management Office
Treasury Bills
Government Gilts

No maximum amount because if we have no capacity to place funds with other financial institutions we need to place them with the government.

Public Authorities

Unitary Authorities
Local Authorities
Borough and District Council’s
Met. Police
Fire and Police Authorities

These authorities do not have credit ratings but statute suggests that credit risk attached to these authorities is an acceptable one.

Exposure limit of £25 Million with a maximum duration of 364 days.

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 Million – no maximum duration as these are instant access funds.