Leeds CITY COUNCIL

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Report of Director of Resources

Report to Executive Board

Date: 10th February 2012

Subject: TREASURY MANAGEMENT STRATEGY 2012/13

Are specific electoral Wards affected? If relevant, name(s) of Ward(s):	☐ Yes	√ No
Are there implications for equality and diversity and cohesion and integration?	☐ Yes	√ No
Is the decision eligible for Call-In? Except recommendation 6.3 to 6.6	√ Yes	☐ No
Does the report contain confidential or exempt information? If relevant, Access to Information Procedure Rule number: Appendix number:	☐ Yes	√ No

Summary of main issues

1. This report sets out for Members' approval the Treasury Management Strategy for 2012/13, and also provides an update on the implementation of the 2011/12 strategy.

2. The Council's level of net external debt is anticipated to be £1,593m by 31/03/12, £16m below expectations in November 2011. Full year revenue savings of £7.1m from treasury management activity are anticipated for 2011/12, including £3.9m assumed in the budget.

3. The debt budget is forecast to rise by £4.6m in 2012/13 when compared to 2011/12. This includes a MRP and treasury savings target of £1.5m.

4. The Authorised limit has been increased to £2.55bn in 2013/14 and £2.6bn in 2014/15. The operational boundary has also been increased to £2.37bn in 2013/14 and £2.425bn in 2014/15. Both these increases relate to other long term liabilities as a result of PFI schemes (Little London, Beeston and Holbeck and Holtpark) that are expected to be included in the balance sheet.

5. Confirmation that the Council has adopted the changes to the 2011 CIPFA edition of the Treasury Management Code of Practice and cross sectoral guide and the Prudential Code.

6. The report also includes an updated Treasury Management Policy Statement for approval. The main changes relate to the use of financial instruments (derivatives) and counter party investment criteria and duration.

Recommendations

That the Executive Board:

7. Approve the initial treasury strategy for 2012/13 as set out in Section 3.3 and note the review of the 2011/12 strategy and operations set out in Sections 3.1 and 3.2.

8. Note that the changes to the CIPFA's Treasury Management Code of Practice and cross sectoral guide and Prudential Code of practice have been adopted and implemented by the Council

That Executive Board recommend to full Council that:

9. The borrowing limits for 2011/12. 2012/13, 2013/14 and 2014/15 be set as detailed in Section 3.4.

10. The treasury management indicators for 2011/12, 2012/13, 2013/14 and 2014/15 be set as detailed in Section 3.5.

11. The investment limits for 2011/12, 2012/13, 2013/14 and 2014/15 be set as detailed in Section 3.6.

12. The revised Treasury Management Policy Statement be adopted.

1 Purpose of this report

1.1 This report sets out for approval by Members the Treasury Management Strategy for 2012/13 and the revised affordable borrowing limits under the prudential framework. It also provides Members with a review of strategy and operations in 2011/12.

2 Background information

2.1 The operation of the Treasury Management function is governed by provisions set out under part 1 of the Local Government Act 2003 whereby the Council is required to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities (amended 2009 and 2011) in particular:

- The Prudential Code requires that full Council set certain limits on the level and type of borrowing before the start of the financial year together with a number of Prudential indicators.
- Any in year revision of these limits must be set by Council.
- Policy statements are prepared for approval by the Council at least two times a year.

3 Main Issues

3.1 Review of Strategy and Borrowing Limits 2011/12

3.1.1 The current debt forecasts are given in Table 1 below, which shows that net external borrowing is now expected to be £1,593m by the end of 2011/12. This is £16m less than expected in November 2011 and is due to slippage in the capital programme. A capital programme update is included as a separate agenda item.

Table 1

ANALYSIS OF BORROWING 2011/12	2011/12 Feb 11 Report £m	2011/12 Nov 11 Report £m	2011/12 This Report £m
Net Borrowing at 1 April	1,515	1,457	**1,457**
New Borrowing for the Capital Programme – Non HRA	104	129	**114**
New Borrowing for the Capital Programme – HRA	3	3	**2**
Debt redemption costs charged to Revenue (Incl HRA)	(32)	(32)	**(32)**
Reduced/(Increased) level of Revenue Balances	33	52	**52**
Net Borrowing at 31 March*	1,623	1,609	1,593
Capital Financing Requirement			**1,786**
* Comprised as follows			
Long term borrowing Fixed	1,386	1,319	1,389
Variable (less than 1 Year)	55	40	20
New Borrowing	108	216	135
Short term Borrowing	95	65	81
Total External Borrowing	1,644	1,640	1,625
Less Investments	21	31	32
Net External Borrowing	**1,623**	**1,609**	**1,593**
% borrowing funded by short term and variable rate loans	16%	20%	15%

Note: The Capital Financing Requirement (CFR) is the maximum level of debt (i.e. borrowing and finance leasing) that the Council can hold for its current year capital purposes. The Council is also allowed to borrow in advance for up to two future years capital programmes.

3.1.2 Since the November update on strategy to Executive Board, the overall balance of risks to the economy remain weighted to the downside. At the centre of much of the uncertainty is the ongoing Eurozone sovereign debt crisis which has intensified, rather than dissipated throughout 2011. These problems have led to the rating agency Standard and Poor's downgrading of 9 European counties and the European Financial Stability fund.

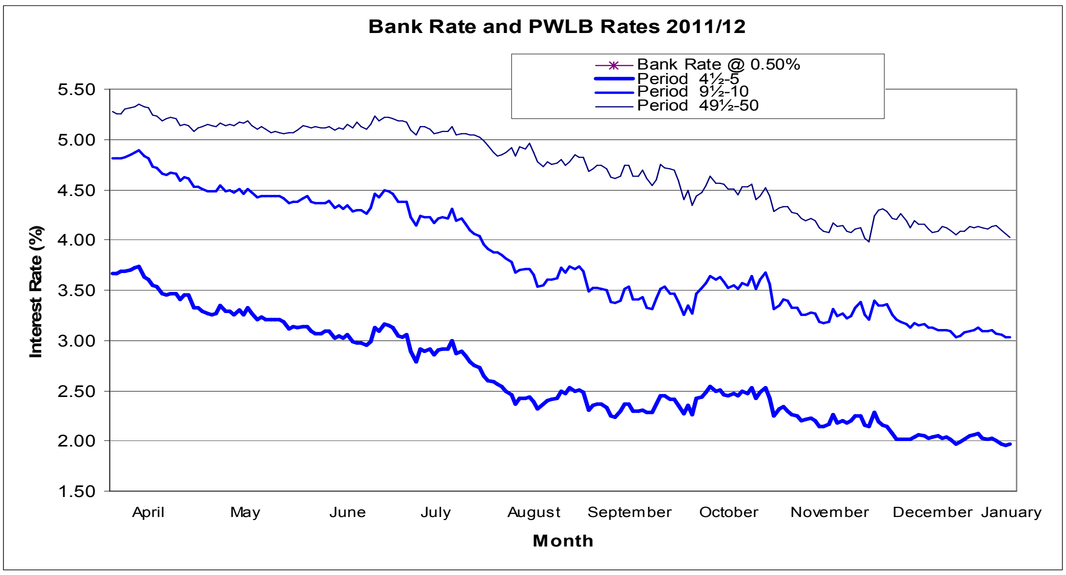
3.1.3 The US economy has encouraged with some positive news around the start of 2012 but any improvement in the weak rate of growth is only likely to generate slow progress in reducing the high level of unemployment which is acting as a dampener on the economy. Hopes for broad based recovery have, therefore, focussed on the emerging markets but these areas have been struggling with inflationary pressures.

3.1.4 The UK Government's austerity measures, aimed at getting the public sector deficit into order over the next four years, have yet to fully impact on the economy. However, coming at a time when economic growth has been weak and concerns at the risk of a technical recession (two quarters of negative growth) in 2012, it looks likely that the private sector will not make up for the negative impact of these austerity measures given the lack of an export led recovery due to the downturn in our major trading partner – the EU. The housing market, a gauge of consumer confidence, remains weak and the outlook is for house prices to be little changed for a prolonged period.

3.1.5 CPI inflation has remained consistently above target in 2011 reaching a high of 5.2% in September. Although inflation has averaged 4.5% in 2011 and remained above the Bank of England's target of 2.0% for the past 25 months, they are confident that inflation will fall back under the target over the next two years. December CPI fell to 4.2% with further falls expected as the effect of the VAT increase last January falls away.

3.1.6 The ratings agencies have recently reaffirmed the UK's AAA sovereign rating and have expressed satisfaction with Government policy for deficit reduction. They have, however, warned that this could be reviewed if the policy were to change, or was seen to be failing to achieve its desired outcome. This position has ensured that the UK government is able to fund itself at historically low levels and, with the safe haven status from Eurozone debt also drawing in external investment, the pressure on gilt rates has been down, and looks set to remain so for some time.

Chart 1



3.1.7 Since the November half year report short term rates have fallen further to new historic low levels, as shown in Chart 1. The Council's treasury advisors' latest forecast for Quarter 1 2012 are that PWLB rates for 50 year borrowing will be around 4.3%, 25 year borrowing around 4.2% and 10 year borrowing around 3.30%. These rates are predicted to remain volatile as the economy starts its recovery process, but are generally anticipated to rise.

3.1.8 The current borrowing strategy continues to fund capital programme borrowing requirement from short dated loans and internal cash balances, whilst allowing longer term funding opportunities to be taken when market conditions are favourable. Table 2 shows £110m of new loans were acquired and also highlights that no rescheduling of long term debt has taken place in 2011/12.

Table 2

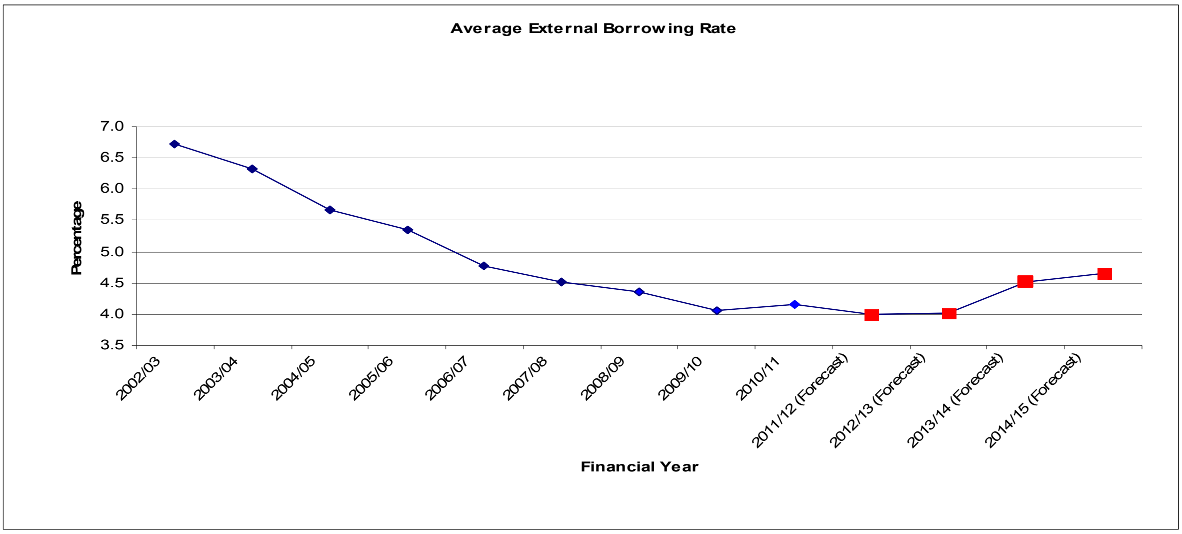
Long term borrowing and Rescheduling 2011/12								
Premature repayments					New Replacement Borrowing			
Date	Amount (£m)	Original Rate (%)	Discount Rate	Premium / (Discount) (£m)	Date	Amount (£m)	Term (Years)	Interest Rate (%)
PWLB								
	None				07/09/2011	10	4.5	2.18
					07/09/2011	10	9.0	3.30
					07/09/2011	10	11.5	3.74
					17/11/2011	10	4.5	2.02
					17/11/2011	10	10.5	3.26
					17/11/2011	10	15.0	3.70
					02/12/2011	20	50.0	3.98
Sub Total	**0**			**0.000**		**80**		
LOBO's (Call Date)								
	None							
Sub Toal	**0**			**0**		**0**		
Market Loans								
	None				01/04/2011	10	1.5	1.57
					15/07/2011	10	2.0	1.45
					01/09/2011	2.5	35.0	3.99
					01/09/2011	7.5	35.0	3.99
Sub Total	**0**			**0**		**30**		
Total	**0**			**0.000**		**110**		

3.1.9 The remaining forecast long term borrowing requirement for 2011/12 is now £216m. This includes £81m of short dated loans. The levels of capital programme slippage, cash reserves, economic conditions and short term interest rates will continue to be monitored before additional monies are borrowed. Given that short term rates continue at historical lows the Council will continue to fund the remaining borrowing requirement, if required at short term rates, whilst taking advantage of long term funding opportunities as they arise.

3.2 Interest Rate Performance

3.2.1 The average rate of interest paid on the Council's external debt for 2010/11 was 4.15% as reported in the Annual Treasury Management Report 2010/11 to Executive Board on 27th July 2011. This rate is now forecast to reduce further to 4.00% for 2011/12. Chart 2 shows how the average, external borrowing rate has fallen from 6.72% in 2002/03. The expectation is that the Councils average cost of borrowing will begin to rise as the cost of borrowing increases and short term funding is switched to more expensive longer term funding rates.

Chart 2



3.3 Strategy for 2012/13

3.3.1 Table 3 shows that net borrowing is expected to rise by £59m to £1,652m during the course of 2012/13. The Capital Programme report is presented elsewhere on this agenda.

Table 3

ANALYSIS OF BORROWING 2011/12 – 2014/15	2011/12 £m	2012/13 £m	2013/14 £m	2014/15 £m
Net Borrowing at 1 April	1,457	1,593	1,652	1,621
New Borrowing for the Capital Programme – Non HRA	114	106	20	28
New Borrowing for the Capital Programme - HRA	2	0	0	0
Debt redemption costs charged to Revenue(Non HRA)	(32)	(37)	(39)	(38)
Reduced/(Increased) level of Revenue Balances	52	(10)	(12)	(12)
Net Borrowing at 31 March	1,593	1,652	1,621	1,599
* Comprised as follows				
Long term borrowing Existing Fixed	1,389	1,535	1,509	1,518
Existing Variable (Less than 1yr)	20	50	130	110
New Borrowing	135	60	(31)	(22)
Short term Borrowing	81	19	20	0
Total External Borrowing	1,625	1,664	1,628	1,606
Less Investments	32	12	7	7
Net External Borrowing	1,593	1,652	1,621	1,599
% gross borrowing exposed to interest rate risk	15%	8%	7%	5%

Note: Borrowing exposed to interest rate risk in any one year is made up of short term borrowing, new long term borrowing and existing variable loans (i.e. LOBOs with an option falling within the year).

3.3.2 Economic forecasting remains troublesome with so many external influences weighing on the UK. There does, however, appear to be consensus among analysts that the economy remains weak and whilst there is still a broad range of views as to potential performance, they have all been downgraded throughout 2011. Key areas of uncertainty include:

- a worsening of the Eurozone debt crisis and heightened risk of the breakdown of the bloc or even of the currency itself;
- the impact of the Eurozone crisis on financial markets and the banking sector;
- the impact of the Government's austerity plan on confidence and growth and the need to rebalance the economy from services to exporting manufactured goods;
- the under-performance of the UK economy which could undermine the Government's policies that have been based upon projected levels of growth that inceasingly seem likely to be undershot;
- a continuation of high levels of inflation;
- the economic performance of the UK's trading partners, in particular the EU and US, with some analysts suggesting that recession could return to both;
- stimulus packages failing to stimulate growth;
- elections due in the US, Germany and France in 2012 or 2013;
- potential for protectionism i.e. an escalation of the currency war / trade dispute between the US and China.

3.3.3 The overall balance of risks remains weighted to the downside. Lack of economic growth, both domestically and overseas, will impact on confidence putting upward pressure on unemployment. It will also further knock levels of demand which will bring the threat of recession back into focus.

3.3.4 The longer term trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries. Given the weak outlook for economic growth, the prospects for any interest rate changes before mid-2013 are limited. There is potential for the start of Bank Rate increases to be delayed even further if growth disappoints.

3.3.5 Low short term interest rates will focus any new borrowing in the very short periods. This strategy will generate lower borrowing costs but it is set against the need to lock in low longer term rates. PWLB rates on loans of less than ten years duration 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. Table 4 shows the forecast of rates by the Council's treasury advisors.

Table 4

	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Mar-14	Mar-15
Sectors Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.50%	1.25%	2.50%
5yr PWLB Rate	2.30%	2.30%	2.30%	2.40%	2.50%	2.90%	3.70%
10ry PWLB Rate	3.30%	3.30%	3.40%	3.40%	3.50%	4.00%	4.80%
25yr PWLB Rate	4.20%	4.20%	4.30%	4.30%	4.40%	4.80%	5.20%
50yr PWLB Rate	4.30%	4.30%	4.40%	4.40%	4.50%	4.90%	5.30%

3.3.6 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 and will be maintained for the borrowing excluding the HRA reform settlement.

3.3.7 Against this background and the risks within the economic forecast, caution will be adopted with the 2012/13 treasury operations. The Director of Resources will continue to monitor market dynamics with a view to securing longer term debt at the appropriate time and as such the strategy will adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates,* e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- *if it was felt that there was a significant risk of a much sharper 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.

3.3.8 The changes to the Housing Subsidy system will mean that the Council will have £107.390m and associated premiums of HRA loans repaid, but will equally no longer receive housing subsidy support for these loans that are redeemed. Work is underway to establish a system that allocates loans and interest costs between the general fund and HRA, as the current statutory method of apportioning debt charges between the general fund and HRA will cease. The overriding principles of the new system must ensure that:

- any apportionment of debt will not be to the detriment of the General Fund.
- the split of loans is broadly equitable between the Housing Revenue Account (HRA) and General Fund.
- Future charges to the HRA in relation to borrowing are not influenced by General Fund decisions, giving a greater degree of independence, certainty and control.
- Un-invested balance sheet resources which allow borrowing to be below the CFR are apportioned between General Fund and HRA.

3.3.9 The requirement to borrow new money is determined by the size of the Council's capital programme. The debt cost of servicing this requirement is shown in the following table.

Table 5	Debt Budget	Increase from the previous year
	£m	£m
2011/12	60,701	-
2012/13	68,583	4,643*
2013/14	74,110	5,527
2014/15	73,573	(537)

* includes £1.504m of MRP and Treasury savings

3.3.10 The debt budget is based upon the interest rate assumptions detailed below in Table 6.

Table 6	Short term rate	Long term rates
2011/12	0.5%	0.5%
2012/13	0.5%	0.5% for 9 months 4.5% for 3 Months
2013/14	2.0%	6.0%
2014/15	6.0%	6.0%

3.3.11 These assumptions on borrowing rates have associated risks. For example in 2012/13 if interest rates are 0.25% higher than assumed on both short and long debt, full year debt costs would increase by £364k

3.4 Borrowing Limits for 2011/12, 2012/13, 2013/14 and 2014/15

3.4.1 The authorised limit represents the legislative limit on the Council's external debt under the Local Government Act 2003. It should be set with sufficient headroom above the operational boundary to allow flexibility for planned borrowing to be undertaken, in order for prudent treasury management decisions to be taken and temporary cash flow fluctuations to be managed. It is recommended that Council approve the following authorised limits for its gross external debt for the next three years.

3.4.2 The operational boundary should reflect the maximum anticipated level of external debt consistent with budgets and cash flow forecasts. It should be seen as a management tool for ongoing monitoring of external debt, and may be breached temporarily due to unusual cash flow movements

3.4.3 The Director of Resources has delegated responsibility to make adjustments between the two separate limits for borrowing and other long term liabilities, provided that the overall limit remains unchanged. Any such adjustments will be reported to the next available Council meeting following the change.

3.4.4 The Authorised limit for borrowing has been rolled forward into 2014/15. The Authorised limit for other long term liabilities has been increased by £50m in 2013/14 and a further £50m in 2014/15 to £700m. This is to reflect the little London and Beeston PFI and Holt Park centre PFI coming on line. As part of the move towards International Financial Reporting Standards, PFI schemes under IFRIC 12 and finance leases are included in the balance sheet under other long-term liabilities.

Recommended: Authorised Limits as follows:

Authorised Limit	**2011/12 £m**	**2012/13 £m**	**2013/14 £m**	**2014/15 £m**
Borrowing	1,900	1,900	1900	1,900
Other Long Term Liabilities	600	600	650	700
Total	**2,500**	**2,500**	**2,550**	**2,600**

3.4.5 The Operational boundary for borrowing has been rolled forward into 2014/15 as outlined below. The operational boundary for other long term liabilities has increased by £45m 2013/14 and a further £55m in 2014/15 to £665m.

Recommended: Operational Boundaries as follows:

Operational Boundary	**2011/12 £m**	**2012/13 £m**	**2013/14 £m**	**2014/15 £m**
Borrowing	1,760	1,760	1,760	1,760
Other Long Term Liabilities	565	565	610	665
Total	**2,325**	**2,325**	**2,370**	**2,425**

3.5 <u>Treasury Management Indicators</u>

3.5.1 Appendix A highlights the borrowing limits and other prudential indicators

3.5.2 The first prudential indicator in respect of treasury management is that the Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Services. This was adopted by the Council at the Executive Board meeting on the 13th March 2003.

3.5.3 The Council is required to set an upper limit on its fixed interest rate exposures that represents the maximum proportion of its net borrowing (i.e. measured as a percentage of its total borrowing less investments) which the Council will have at any given time during the period at fixed interest rates. The purpose of the limit is to ensure that the Council has the flexibility to take advantage of falling interest rates by ensuring a minimum level of variable rate debt. However setting a limit less than 100% can restrict the Council's ability to borrow in advance of need when long term fixed interest rates are at their low point. (This is the case since in general amounts borrowed in advance are invested, meaning that the net borrowing figure on which the limit is based will be lower than the total fixed borrowing outstanding.) Therefore to provide the Council with maximum flexibility it is recommended that the limit of 115% remains unchanged and is rolled forward into 2014/15.

Recommended: Upper limit on fixed interest rate exposures for 2011/12, 2012/13, 2013/14 and 2014/15 of 115% (no change)

3.5.4 The Council is required to set an upper limit on its variable interest rate exposures that represents the maximum proportion of debt the Council will have at any given time during the period at variable interest rates and exposed to interest rate rises. In evaluating this figure, LOBOs are treated as being variable in the year in which an option occurs and fixed in other years. The limit should be set in order to maintain a balance between managing the risk of rate rises and allowing sufficient flexibility to take advantage of any fall in rates. It is therefore recommended that the limit of 40% of debt remains unchanged and is rolled forward into 2014/15.

Recommended: Upper limit on variable interest rate exposures for 2011/12, 2012/13, 2013/14 and 2014/15 of 40% (no change)

3.5.5 The Council is required to set upper and lower limits for the maturity structure of its borrowings. This is designed to limit the risk of exposure to high interest rates by restricting the level of maturing debt in any given year. The limits represent the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. These rate remain unchanged.

Maturity structure of fixed rate borrowing	Lower Limit	Upper Limit
under 12 months	0%	15%
12 months and within 24 months	0%	20%
24 months and within 5 years	0%	35%
5 years and within 10 years	0%	40%
10 years and above	25%	90%

Recommended: Upper and Lower limits on fixed rate maturity structure remains unchanged as above.

3.6 Investment Strategy and Limits

3.6.1 The Council's actual external borrowing need is reduced by the availability of revenue balances. The Treasury policy allows for the external investment of these balances at advantageous rates but with due regard for security of capital invested. Investment of surplus balances in general will be limited to cash flow and liquidity management although the interest rate outlook will be kept under review to identify any opportunities for longer term investment.

3.6.2 The approved lending list is based upon the assessment of the financial standing of counterparties as determined by international credit rating agencies and further refined and updated by the Council's advisors on a continual basis. The lending list is often further restricted based upon the Council's own view of the credit worthiness of counter-parties.

3.6.3 The investment strategy allows for the Council to invest in only the most highly rated financial institutions around the world. The Council will only lend up to a maximum of £15m to financial institutions that are rated as excellent. There is also a limit of £5m for financial institutions that are rated as very good.

3.6.4 The Prudential code requires that Councils set limits on investments for periods longer than 364 days. It is proposed to maintain the limits as outlined below and roll the amount forward into 2014/15.

Recommended: Upper limit on sums invested for periods longer than 364 days (no change):

Total principal sum invested for a period longer than 364 days	2011/12 £m	2012/13 £m	2013/14 £m	2014/15 £m
Upper limit	150	150	150	150

3.7 <u>Changes to CIPFA Code of Practice and cross sectoral guide and Prudential Code</u>

3.7.1 CIPFA have issued a revised Treasury Management Code of Practice and cross sectoral guide and Prudential Code. Appendix C shows the changes that have been made and the confirmation that the Council has adopted all of the changes.

3.8 <u>Treasury Management Policy Statement</u>

3.9 The Policy has been updated to reflect that local authorities now have the power to use derivatives for interest rate risk management. These instruments will only be used after a review of their appropriateness for interest rate risk management is undertaken. These changes are reflected in section 6.3 of the treasury management policy (appendix D)

3.9.1 The criteria for counter party investment has been updated to reflect amended investment durations in section 7.5 of Appendix D.

4 Corporate Considerations

4.1 Consultation and Engagement

4.1.1 This report is an update on strategy as presented to Executive Board in February, as such no consultation has taken place. However, consultation with the Council's treasury advisors takes place regularly throughout the year.

4.1.2 The borrowing requirement is an outcome of the capital programme which has been the subjected of consultation and engagement as outlined in the capital programme Update elsewhere on this agenda.

4.2 Equality and Diversity / Cohesion and Integration

4.2.1 Equality, diversity, cohesion and integration requirements are addressed as part of individual capital scheme and programme approvals. The borrowing to deliver these capital schemes is executed through treasury strategy and as such there are no further equality diversity cohesion and integration issues.

4.3 Council Policies and City Priorities

4.3.1 Treasury Management strategy secures funding to support the Council's Policies and City Priorities as set out in the Council capital programme and is consistent with the Council's business plan.

4.4 Resources and Value for Money

4.4.1 This update on the treasury strategy recognises the borrowing necessary to fund the capital programme requirements of both General Fund and HRA. The revenue costs of borrowing are included within the revenue budgets of the general fund and HRA.

4.4.2 The updated strategy 2011/12 is forecast to deliver savings of £3.2m against the budgeted position, or £7.1m if you include the budgeted treasury saving of £3.9m.

4.5 Legal Implications, Access to Information and Call In

4.5.1 In accordance with the Council's Budget and Policy Framework, decisions on borrowing limits, treasury management indicators, investment limits and the Treasury management Policy Statement are approved by Council. As such, recommendations 6.3 to 6.6 are not subject to call in.

4.6 Risk Management

4.6.1 This report sets out the framework for the treasury strategy for the year ahead. The execution of strategy and associated risks are kept under regular review through:

- Monthly reports to the Finance Performance Group
- Monthly dashboard reporting to CLT
- Quarterly strategy meeting with the Director of Resources and the Council's treasury advisors
- Regular market, economic and financial instrument updates and access to real time market information
- Regular treasury management meetings with the Core Cities and West Yorkshire Districts.

5 Conclusions

5.1 The Council's level of external debt at 31st March 2011 is anticipated to be £1,593m, £16m below expectations in November 2011.

5.2 The continued low interest rate environment coupled with treasury management activity has enabled revenue savings of £7.1m to be made against £3.9m assumed in the budget. This is largely due to funding the Council's borrowing requirement from short-term loans at historic low rates and internal cash balances, in lieu of more expensive longer term funding at much higher rates.

5.3 The uncertainty and risks around economic forecasts will result in further caution being adopted in the 2012/13 treasury management of debt and investments. The Director of Resources will continue to monitor market dynamics with a view to securing longer term debt at the appropriate time.

5.4 The revisions to CIPFA's Treasury Management Code of Practice and cross sectoral guide and Prudential Code of Practice have been adopted and implemented by the Council.

5.5 The Treasury Management Policy Statement has been updated to reflect the use of financial instruments including derivatives and the criteria for counter party investment has been updated to reflect amended investment durations.

6 Recommendations

That the Executive Board:

6.1 Approve the initial treasury strategy for 2012/13 as set out in Section 3.3 and note the review of the 2011/12 strategy and operations set out in Sections 3.1 and 3.2

6.2 Note that the changes to the CIPFA's Treasury Management Code of Practice and cross sectoral guide and Prudential Code of practice have been adopted and implemented by the Council

That Executive Board recommend to full Council that:

6.3 The borrowing limits for 2011/12. 2012/13, 2013/14 and 2014/15 be set as detailed in Section 3.4.

6.4 The treasury management indicators for 2011/12, 2012/13, 2013/14 and 2014/15 be set as detailed in Section 3.5.

6.5 The investment limits for 2011/12, 2012/13, 2013/14 and 2014/15 be set as detailed in Section 3.6.

6.6 The revised Treasury Management Policy Statement be adopted.

7 Background documents

7.1 Treasury Management Strategy 2011/12 - Executive Board 11th February 2011.
7.2 Treasury Management annual report 2010/12 – Executive Board 27th July 2011
7.3 Treasury Management strategy update 2011/12 – Executive Board 2nd November 2011

Leeds City Council - Prudential Indicators 2011/12- 2014/15

No.	PRUDENTIAL INDICATOR	2011/12	2012/13	2013/14	2014/15
	(1). EXTRACT FROM BUDGET AND RENT SETTING REPORTS				
	Ratio of Financing Costs to Net Revenue Stream				
1	General Fund - Excluding DSG (Note1)	10.49%	12.25%	13.19%	13.06%
2	HRA	13.32%	12.57%	13.59%	13.24%
	Estimates of the Incremental Impact of new capital investment decisions	£ . P	£ . P	£ . P	£ . P
3	increase in council tax B7(band D, per annum) (Note 2)	11.86	48.94	75.81	82.86
4	increase in housing rent per week	0.00	0.00	0.00	0.00
		£'000	**£'000**	**£'000**	**£'000**
5	**Net external borrowing requirement**	1,593,000	1,653,000	1,622,000	1,600,000
	The Net Borrowing Requirement should not exceed the capital financing requirement (Note 3)	OK	OK	OK	OK
	Estimate of total capital expenditure	**£'000**	**£'000**	**£'000**	**£'000**
6	Non HRA	213,922	194,909	113,333	59,273
7	HRA	53,976	66,140	92,908	92,778
	TOTAL	267,898	261,049	206,241	152,051
	Capital Financing Requirement (as at 31 March)	**£'000**	**£'000**	**£'000**	**£'000**
8	Non HRA	1,480,277	1,538,558	1,530,835	1,506,862
9	HRA	808,336	719,654	773,344	842,014
	TOTAL	2,288,613	2,258,212	2,304,179	2,348,876
9a	**Limit of HRA Indebtedness as implemented under self financing**	n/a	726,155	726,155	726,155

No.	PRUDENTIAL INDICATOR	2011/12	2012/13	2013/14	2014/15
	(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£'000	£'000	£'000	£'000
10	**Authorised limit for external debt - (Note 5)**				
	borrowing	1,900,000	1,900,000	1,900,000	1,900,000
	other long term liabilities	600,000	600,000	650,000	700,000
	TOTAL	2,500,000	2,500,000	2,550,000	2,600,000
11	**Operational boundary - (Note 5)**				
	borrowing	1,760,000	1,760,000	1,760,000	1,760,000
	other long term liabilities	565,000	565,000	610,000	665,000
	TOTAL	2,325,000	2,325,000	2,370,000	2,425,000
14	**Upper limit for fixed interest rate exposure**				
	expressed as either:-				
	Net principal re fixed rate borrowing / investments OR:-	115%	115%	115%	115%
	Net interest re fixed rate borrowing / investments				
15	**Upper limit for variable rate exposure**				
	expressed as either:-				
	Net principal re variable rate borrowing / investments OR:-	40%	40%	40%	40%
	Net interest re variable rate borrowing / investments				
		£'000	**£'000**	**£'000**	**£'000**
17	**Upper limit for total principal sums invested for over 364 days (Note 5)**	150,000	150,000	150,000	150,000
	(per maturity date)				

16	Maturity structure of fixed rate borrowing 2012/13	Lower Limit	Upper Limit	Projected 31/03/2012
	under 12 months	0%	15%	3%
	12 months and within 24 months	0%	20%	11%
	24 months and within 5 years	0%	35%	20%
	5 years and within 10 years	0%	40%	9%
	10 years and above	25%	90%	57%

Notes.

1 **The indicator for the ratio of financing costs to net revenue stream for General Fund is now calculated based on the Net Revenue Charge less the Dedicated Schools Grant (DSG). The Government changed the funding of education to DSG from 2006/07.**

2 **The code requires that the Council identifies the capital financing costs arising from unsupported borrowing expressed as the amount per band D property.**

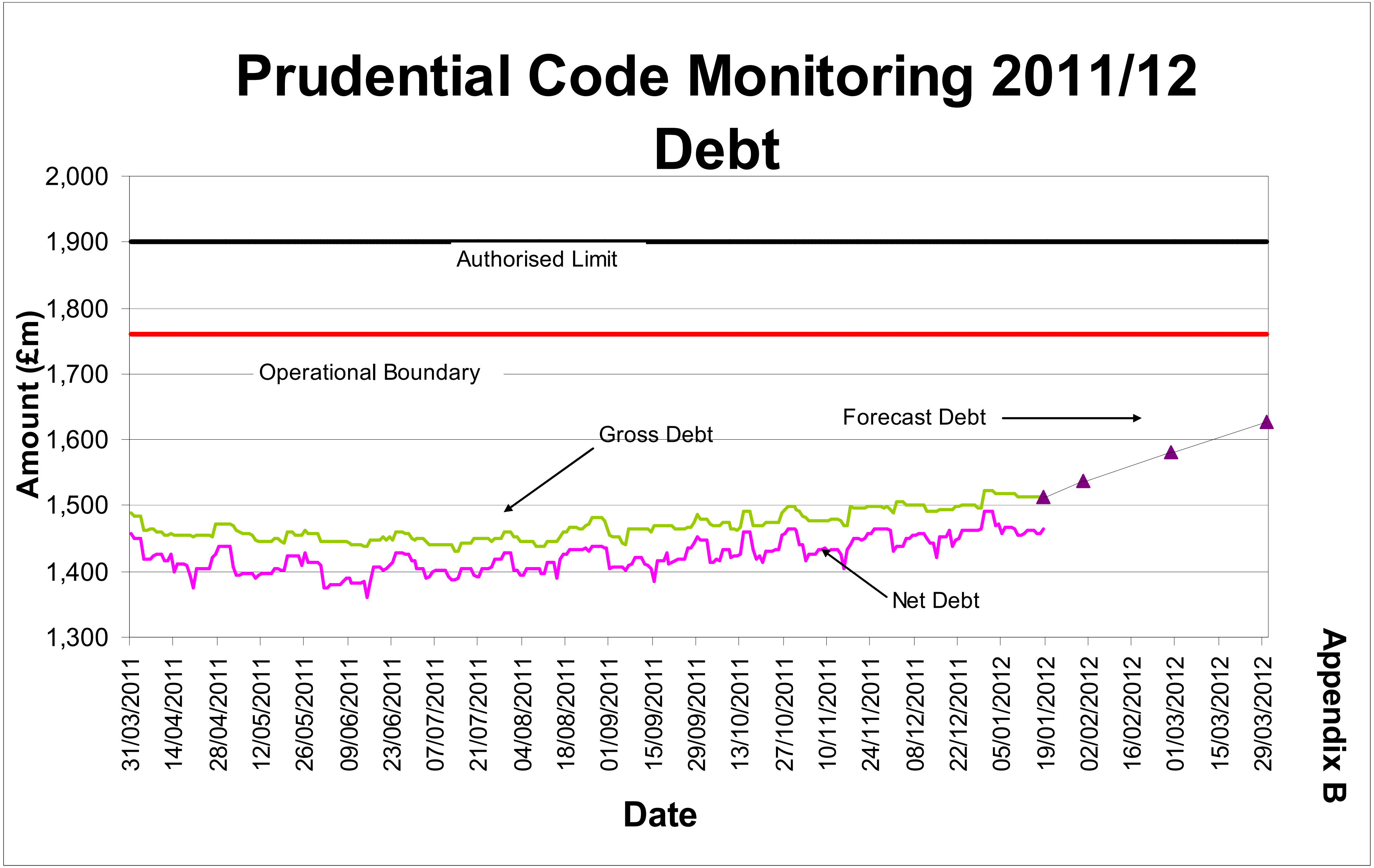
3 **In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council should ensure that net external borrowing does not exceed the total capital financing requirement in the preceding year plus estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.**

4 **Prudential indicator 12 relates to actual external debt at 31st March, which will be reported in the Treasury Management Annual Report.**

5 **Prudential indicator 13 relates to the adoption of the CIPFA Code of Practice on Treasury Management amended 2011 and has been formally adopted**

6 **Indicator 9 has been updated from 12/13 to reflect the implementation of the HRA self financing regime from 01/04/2012. and the repayment of £107.390m of PWLB loans.**

7 **Indicator 9a is new under the 2011 Code. This indicator is yet to be finalised by the DCLG and is subject to discussions with the DCLG due to transitional issues surrounding the inclusion of PFI schemes currently in progress. The impact of these PFI schemes is included within the forecast HRA CFR in indicator 9**



Prudential Code Monitoring 2011/12
Debt
2,000
1,900
1,800
1,700
1,600
1,500
1,400
1,300
Amount (£m)
Authorised Limit
Operational Boundary
Forecast Debt
Gross Debt
Net Debt
31/03/2011
14/04/2011
28/04/2011
12/05/2011
26/05/2011
09/06/2011
23/06/2011
07/07/2011
21/07/2011
04/08/2011
18/08/2011
01/09/2011
15/09/2011
29/09/2011
13/10/2011
27/10/2011
10/11/2011
24/11/2011
08/12/2011
22/12/2011
05/01/2012
19/01/2012
02/02/2012
16/02/2012
01/03/2012
15/03/2012
29/03/2012
Date

Appendix B

<u>Appendix C</u>

The Treasury Management Code of Practice and Cross -Sectoral Guidance notes in the Public Services

Purposes

Ref	Sub Heading	Notes	Action
3	Transparency	"To provide transparency for TM decisions including the use of counterparties and financial instruments that individual public Service organisations intend to use for the prudent management of their financial affairs"	Implemented

Key Principles

Ref	Sub Heading	Notes	Action
2.	Risk	Addition to statement "…Including the use of financial instruments for the management of those risks"	Implemented

The Treasury management policy statement (TMPS)

Ref	Sub Heading	Notes	Action
2.	None	Addition of words "….and any financial instruments entered not to manage these risks"	Implemented
End	New section	Addition of sentence. "The policy statement should include the organisation's high level policies for borrowing and investment"	Implemented

Treasury management practices (TMP's)

Ref	Sub Heading	Notes	Action
Gen	None	TMP's should be the subject of scrutiny after recommendation by CFO.	Implemented
Tmp1	[3] Interest rate risk	New statement added "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".	Implemented
Tmp4	None	New paragraph added "Where this organisation intends to use derivative instruments for the management of risks, these will be limited to those set out in its annual treasury strategy. The org 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."	Implemented

Cross-Sectoral Guidance Notes

Ref	Sub Heading	Notes	Action

1.1	Risk Management	Additional Sentence 2nd Para "Some public service organisations may use derivatives for the management of risk; where this is the case PSO's should satisfy themselves that they understand fully how underlying risks are affected and any additional risks that may result."	Implemented
	5.	Replacement of words "Credit Limit" with "acceptable credit quality" "the main rating agencies" with "the published credit ratings (where available)"	Implemented
	6.	Replacement of Words "on the basis of the lowest rating" with "based on all ratings"	Implemented
	7	Replacement of words "..and the credit ratings of that Gov support" with "…, including the ability and willingness of the relevant government to provide adequate support"	Implemented
	17.	New Para "Where an org seeks to manage its exposures to interest rate or exchange rate fluctuations by use of specific financial instruments such as derivatives, it should be clear about its policies in its annual strategy. It should only use such instruments for the prudent management of its financial affairs and should fully understand the instruments and risks it is managing."	Implemented
	26.	Addition of words "…., derivatives"	Implemented
1.3	Decision Making and Analysis		
	1.	Regular review by board members/Councillors and executive/scrutiny functions	Implemented
	4.	Last sentence " …and, if relevant, the opportunities for foreign currency funding" This is specifically excluded under the 2003 Act in that no foreign currency borrowing can be undertaken unless at the direction of the secretary of state.	Implemented
1.4	Approved method instruments and techniques		
	6.	CIPFA requirement to review approved lists and to ensure skills/resources are present to use all entries on the list	Implemented
1.11	Use of External Service Providers		
	3.	Deletion of the Sentence "And it is not uncommon for their services to be subject of a competitive tendering process every few years"	Implemented
	7.	Deletion of Sentence "Organisations should be clear that the services provided meet their needs and these, too, should be the subject of regular competitive tendering in accordance with Standing Orders."	Implemented
	9.	New Sentence "Other external providers may include software providers, Investments Banks and Credit rating agencies"	Implemented
	10.	Deletion of Sentence. (See 12) "The overall responsibility for Treasury Management must always remain with the Organisation." Addition of new sentence	Implemented

		" Services should be subject to regular competition which would usually be via a competitive tendering process."	
	11.	New Section "Organisations should be mindful of the requirements of the Bribery Act 2010 in their Dealings with external providers"	Implemented
	12.	New section (See 10) "The overall responsibility for Treasury Management must always remain with the Organisation."	Implemented

Suggested Schedules to Accompany and organisations statement of its Treasury Management Practices (TMP's)

Ref	Sub Heading	Notes	Action
6	RM-Interest Rate	Addition of Statement " Policies concerning the use of Financial Derivatives for interest rate risk management"	Implemented

The Prudential Code for Capital Finance in Local Authorities

Matters required to be taken into account when setting up or revising Prudential Indicators

Ref	Sub Heading	Notes	Action
13	Affordability and prudence	Inserted "and the Local Government Finance Act (Northern Ireland) 2011" in 1st sentence Inserted " (….and Northern Ireland)" in 1st sentence Inserted new 2nd sentence "For England, Wales and northern Ireland, the legislation requires authorities to consider credit arrangements in this calculation and for Scotland, the affordability calculation encompasses both the borrowing of money and other long term liabilities arising from capital investment."	Implemented

Prudential indicators for capital expenditure, external debt and treasury management

Ref	Sub Heading	Notes	Action
51	Need to borrow	Change of words from "…to borrow" to "…to finance capital expenditure by borrowing or other long term liability arrangements."	Implemented

Definitions

Ref	Sub Heading	Notes	Action
68	Debt	Change from "It should be noted that the term borrowing used within the LGA 2003 includes both borrowing as defined for the balance sheet and other long term liabilities defined as credit arrangements through legislation. This means that the definition of 'debt' for the purposes of the pru Code is the same as the definition of 'borrowing' under the LGA 2003"	Implemented

		And replaced by "It should be noted for authorities in England, Wales and Northern Ireland that the LGA 2003 and the LGF (NI) Act 2011 require credit arrangements to be treated as borrowing of money for the purposes of determining the affordable borrowing limit and the imposition of borrowing limits. In Scotland…." Newly added statement "net debt is debt which is net of investments (Para70)"	
69	Financing Costs	New aggregate added "Amount payable or receivable in respect of financial derivatives" Last point on MRP and depreciation /impairment split in 2 as follows MRP "Any amounts required for the statutory provision for the repayment of debt, currently MRP (eng and Wales), loans fund repayments and repayments of other long term liabilities - PFI and finance leases (Scotland) and general fund charges for loan principal(NI), plus and additional voluntary contributions." Depreciation/Impairment "any amounts for depreciation/impairment that are charged to the amount to be met from government grants and local tax payers."	Implemented
73	Other Long Term Liabilities	New 1st Paragraph added " 'Other long term liabilities' in this code relate to the liabilities which are outstanding under credit arrangements (as defined by statue for authorities in England, Wales and NI). the objective is to identify liabilities outstanding (Other than borrowing) in relation to the financing of capital expenditure."	Implemented

Local authorities with housing functions

Ref	Sub Heading	Notes	Action
76	Scope of HRA	New sentence added "Such authorities should also have regard to the ' Treasury Management Implications of the Housing Self-Financing Reform' section of CIPFA's TM Code of Practice (2011 edition)	Implemented
86	HRA Limit on indebtedness	New Section. ****New Indicator***** Where relevant, the local authority will report the level of the limit imposed(or subsequently amended) at the time of implementation of self financing by the department for communities and Local government. It is the HRACFR which will be compared to this limit.	Implemented

Appendix 1 CFR

Ref	Sub Heading	Notes	Action
Introduction			
90	Revbals & OLTL	Addition of final sentence "It includes other long-term liabilities associated with credit arrangements, such as PFI and finance leases."	Implemented
91	Borrowing CFR	Replace "In contrast, The CFR will reflect the local Authority's underlying need to borrow for a capital purpose" With "The CFR will reflect the local authority's underlying need to finance Cap exp by borrowing or OLTL arrangements"	Implemented
92	Drivers of CFR	Addition of new clause "The CFR will increase when a new other long term liability is entered into" Note this will not be the borrowing CFR however	Implemented
Calculation of CFR			
93	Requirement of Prudential Code	Change to definition of long term debtors and any amounts carried as investments that were treated as capital expenditure. Addition of clauses "Where applicable" & "as applicable"	Implemented

Appendix D

Treasury Management Policy Statement

1 Introduction

1.1 The following document sets out the Treasury Management Policy Statement (TMPS) for the Authority, which fully complies with the requirements of the Prudential Code.

2 Background

2.1 CIPFA first published its Code of Practice on Treasury Management in May 1992. There have been subsequent revisions over the years culminating in the latest version of the code, the fully revised Third edition 2011, which recommends that all public service organisations adopt, as part of their standing orders and financial procedures, the following four clauses.

a) This Authority adopts the key recommendations of CIPFA's *Treasury Management in the Public Services: Code of Practice* (the Code), as described in Section 4 of that Code.

b) Accordingly, this Authority will create and maintain, as the cornerstones of effective treasury management:

- A TMPS, stating the policies and objectives of its treasury management activities
- Suitable Treasury Management Practices (TMP’s), 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.

c) The Executive Board 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 half year update and an annual report after its close, in the form prescribed in its TMP’s.

d) This organisation delegates responsibility for the implementation and monitoring of its treasury management policies and practices to the Executive Board, and for the execution and administration of treasury management decisions to the Director of Resources, who will act in accordance with the organisation's TMPS and Treasury Management Practices and, if he/she is a CIPFA member, CIPFA's *Standard of Professional Practice on Treasury Management.*

2.2 CIPFA recommends that an organisation's TMPS adopts the following forms of words to define the policies and objectives of its treasury management activities:

- This organisation defines its treasury management activities as: "The management of the organisation's 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 organisation 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 organisation 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 best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management."

2.3 These key recommendations and form of words as specified above were adopted by the Executive Board on the 12th March 2003.

2.4 The operation of the Treasury Management function is governed by provisions set out under part 1 of the Local Government Act 2003 whereby the Council is required to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities.

2.5 The Prudential Code requires that full Council set certain limits on the level and type of borrowing before the start of the financial year together with a number of Prudential indicators. Any in year revision of these limits must similarly be set by Council.

2.6 The requirements of the Prudential Code are set out within the Council's Financial Procedures.

3 Objectives of Treasury Management

3.1 The primary objective is to reduce the cost of debt management with which the other objectives are deemed to be consistent. Varying degrees of emphasis will be placed upon the "secondary objectives" at different times contingent upon prevailing market conditions.

3.2 The objectives are identified as follows:

a) To reduce the cost of debt management;

b) To ensure that the management of the HRA and general fund is treated equally and new accounting principles are examined to provide benefits where possible;

c) To effect funding at the lowest point of the interest rate cycle;

d) To maintain a flexible approach regarding any financial matters that may effect the Authority;

e) To keep under constant review advice on investment/repayment of debt policy;

f) To maintain a prudent level of volatility dependant upon interest rates;

g) To set upper and lower limits for the maturity structure of its borrowings and to maintain a reasonable debt maturity profile;

h) To specifically ensure that Leeds City Council does not breach Prudential Limits passed by the Council;

i) To ensure that the TMPS is fully adhered to in every aspect.

4 Approved Activities of the Treasury Management Operation

4.1 The approved activities of the Treasury Management operation cover:

a. borrowing;

b. lending;

c. debt repayment and rescheduling;

d. financial instruments new to the authority (including financial derivatives);

e. risk exposure; and

f. cash flow.

4.2 It is the Council's responsibility to approve the TMPS. The Executive Board will receive and consider as a minimum:

a) an annual treasury management strategy before the commencement of the new financial year (which sets out the likely operations for the forthcoming year);

b) a mid year update on treasury strategy;

c) an annual report on the treasury management activity after the end of the year to which it relates.

4.3 The Director of Resources will:

a) implement and monitor the TMPS, revising and resubmitting it for consideration to the Board and the Council, periodically if changes are required;

b) draft and submit a Treasury Management Strategy to the Board, in advance of each financial year;

c) draft and submit an update report on treasury management activity to the Board

d) draft and submit an annual report on treasury management activity to the Board; and

e) implement and monitor the Strategy, reporting to the Board any material divergence or necessary revisions as and when required;

5 Formulation of Treasury Management Strategy

5.1 Whilst this TMPS outlines the procedures and considerations for the treasury function as a whole, requiring revision occasionally, the Treasury Management Strategy sets out the specific expected treasury activities for the forthcoming financial year. This Strategy will be submitted to the Executive Board for approval before the commencement of each financial year.

5.2 The formulation of the annual Treasury Management Strategy involves determining the appropriate borrowing and investment decisions in the light of the anticipated movement in both fixed and shorter term variable interest rates (for instance, the Council may postpone borrowing if fixed interest rates are falling).

5.3 The Treasury Management Strategy is also concerned with the following elements:

a) the prospects for interest rates;

b) the limits placed by Council on treasury activities (per this TMPS);

c) the expected borrowing strategy;

d) the temporary investment strategy;

e) the expectations for debt rescheduling.

5.4 The Treasury Management Strategy will establish the expected move in interest rates against alternatives (using published forecasts where applicable), and highlight sensitivities to different scenarios.

6 Approved Methods and Sources of Raising Capital Finance

6.1 Under the Local Government Act 2003 a local authority may borrow money for:

a) for any purpose relevant to its functions under any enactment, or
b) for the purposes of the prudent management of its financial affairs.

A local authority may not, without the consent of the Treasury, borrow otherwise than in sterling.

6.2 Local authorities have in the past only been able to raise finance in accordance with the Local Government and Housing Act 1989, and within this limit the Council has a number of approved methods and sources of raising capital finance. These are:

		Fixed	Variable
	Public Works Loans Board (PWLB)	●	●
	European Investment Bank (EIB)	●	●
*	Stock Issues	●	●
	Market Long-Term	●	●
	Market Temporary	●	●
	Local Temporary	●	●
*	Local Bonds	●	
	Overdraft		●
*	Negotiable Bonds	●	●
	Internal (capital receipts & revenue balances)	●	●
*	Commercial Paper	●	
*	Medium Term Notes	●	
	Finance Leases	●	●

* (Not used at present by this Council)

6.3 The revised treasury management code of practice (2011), through the Localism Act 2011, gave local authorities the power to use derivatives for interest rate risk Management. These instruments will only be used after a review of their appropriateness for interest rate risk management is undertaken.

7 Approved Instruments and Organisations for Investments

7.1 With effect from the 1st April 2004, to coincide with the introduction of the prudential code, new legislation has been issued to deal with the issue of Local Government Investments. This legislation lifts the restrictions on Councils with external debt to not hold investments for more than 364 days. Further freedoms are also provided which will give Councils greater flexibility and hence access to higher returns, provided that any investment strategy is consistent with the new prudential framework.

7.2 The Council will have regard to the CLG Guidance on Local Government Investments (second Edition) issued in March 2010 and CIPFAs Treasury Management in Public Services Code of Practice and Cross Sectrorial Guide. The Council's investment priorities are:

a) The security of capital

b) The liquidity of investments

c) and finally, the yield of the investment

7.3 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The Council does not have the authority to undertake borrowing purely to invest or lend and make a return as this is unlawful and as such will not engage in such activity.

7.4 The Director of Resources will formulate suitable criteria for assessing and monitoring the credit risk of investment counterparties and shall construct a lending list comprising time, type and specific counterparty limits. This criteria is outlined below. Should any revisions occur to the criteria, they will be submitted to the Executive Board for approval. Where individual counterparties newly obtain the required criteria, they will be added to the list. Similarly, those ceasing to meet the criteria will be immediately deleted. The criteria uses ratings from the three rating agencies and those relating to Fitch are explained in Annexe A.

7.5 The Council's approved Treasury Policy is to use the recommended lending list provided by Sector, the Council's treasury advisers. The Sector list is compiled on a matrix approach using data from recognised international credit rating agencies as well as information on individual counterparties drawn from Credit Default Swap (CDS) levels, which provide ratings of institutions across four categories. The Sector list had in the past ranked institutions as 'excellent' (or 'purple', 'red' and 'Orange'), 'good' (or 'green'), or no ranking (i.e. not advised to lend to). Sector has now further split the rankings of institutions regarded as excellent into five colours (red, orange, blue, purple and yellow) to reflect the length of time over six months that amounts can be placed with them and to reflect the explicit support level given to UK part nationalised banks (Blue), and the special category for investment in UK gilts, supranationals and collateralised deposits (Yellow). Sector continues to provide regular updates to this list, as institutions' credit ratings change. The use of the Sector list was introduced and reported to Executive Board in the Treasury Strategy and Policy report of February 2002.

The following investment limits are applied by the Council's Treasury policy:

Sector Ranking	Meaning	Limit on Amount Lent	Current Limits on Duration
General Bank			
Green	Good	£5m	3 Months
Red	Excellent	£15m	6 Months
Orange	Excellent	£15m	1 Year
Purple	Excellent	£15m	2 Years
Other			
Blue	Excellent	£15m	1 Year
Yellow	Excellent	£15m	5 Years

The CDS subjective overlay is then applied to the General banks and further reduces the suggested limits of duration as shown in the following table:

Initial Duration (Months)		Suggested Duration (watch/ outlook)		CDS Status		Suggested Adjusted Colour		Adjusted Duration (Months)
0	→	N/C	+	In Range	=	N/C	→	0
0	→	N/C	+	Monitoring	=	N/C	→	0
0	→	N/C	+	Out of Range	=	N/C	→	0
3	→	G	+	In Range	=	G	→	3
3	→	G	+	Monitoring	=	N/C	→	0
3	→	G	+	Out of Range	=	N/C	→	0
6	→	R	+	In Range	=	R	→	6
6	→	R	+	Monitoring	=	G	→	3
6	→	R	+	Out of Range	=	N/C	→	0
12	→	O	+	In Range	=	O	→	12
12	→	O	+	Monitoring	=	R	→	6
12	→	O	+	Out of Range	=	N/C	→	0
24	→	P	+	In Range	=	P	→	24
24	→	P	+	Monitoring	=	O	→	12
24	→	P	+	Out of Range	=	N/C	→	0

7.6 The Council will lend up to £15 million to an institution ranked as 'excellent' and up to £5 million for up to 3 months to an institution ranked as 'good'. A number of these institutions exist within the same group of companies as parents or subsidiaries. A limit to the risk exposure of the council for groups of banks borrowing limit has also been set of £30m. These limits do not apply to the Councils' Banker where we have an unlimited deposit facility as part of our banking arrangements. The Council's banking arrangements are the subject of a separate contract, and as such volumes and levels of transactions are not subject to the counterparty ratings and limits that are in place on external investments.

Other local authorities are classified with an excellent rating and as such attract a £15m investment limit.

7.7 Within the investment limits outlined above the Council has access to a number of investment instruments. These are listed below as specified and non specified investment categories. Specified investments are defined as "minimal procedural formalities" under the March 2004 ODPM guidance revised 2010 under DCLG.

a) **Specified Investments**

(All such investments will be sterling denominated, with **maturities of any period meeting** the minimum 'high' rating criteria where applicable)

Fixed Term Deposits with fixed rates	**Use**
Debt Management Agency Deposit Facility	In-house
Term deposits – local authorities	In-house
Term deposits – banks and building societies	In-house and fund managers

In the following table the determination as to whether the following are specified or non specified is at the discretion of the Authority depending on the element of the return that is fixed, **provided that the maturity of the investment falls within 1 year.**

Fixed term deposits with variable rate and variable maturities: -	
1. Callable deposits	In-house and fund managers
2. Range trade	In-house and fund managers
3. Snowballs	In-house and fund managers
Certificates of deposits issued by banks and building societies	In-house buy and hold and fund managers
UK Government Gilts	In-house buy and hold and Fund Managers
Bonds issued by multilateral development banks	In-house on a 'buy-and-hold' basis. Also for use by fund managers
Bonds issued by a financial institution which is guaranteed by the UK government	In-house on a 'buy-and-hold' basis. Also for use by fund managers
Sovereign bond issues (i.e. other than the UK govt)	In house on a 'buy and hold basis' and Fund Managers
Treasury Bills	Fund Managers
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs):	
1. Money Market Funds	In-house and fund managers
2. Enhanced cash funds	In-house and fund managers
3. Short term funds	In-house and fund managers
4. Bond Funds	In-house and Fund Managers
5. Gilt Funds	In-house and Fund Managers

Note: If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate.

b) **<u>Non-Specified Investments</u>**:

Non-specified investments are those where the return is uncertain.

Maturities of ANY period.

	Use
Corporate Bonds : ***the use of these investments would constitute capital expenditure***	In house on a 'buy and hold basis' and Fund Managers
Floating Rate Notes : ***the use of these investments would constitute capital expenditure unless they are issued by a multi lateral development bank***	Fund managers

All the investments in the following table are non-specified as returns could be uncertain and **the maturity of the investment is greater than 1 year.**

Fixed term deposits with variable rate and variable maturities	
1. Callable deposits	In-house and fund managers
2. Range trade	In-house and fund managers
3. Snowballs	In-house and fund managers
Certificates of deposits issued by banks and building societies	In house on a 'buy and hold basis' and Fund managers
UK Government Gilts	In house on a 'buy and hold basis' and Fund Managers
Bonds issued by multilateral development banks	In-house on a 'buy-and-hold' basis. Also for use by fund managers
Bonds issued by a financial institution which is guaranteed by the UK government	In-house on a 'buy-and-hold' basis. Also for use by fund managers
Sovereign bond issues (i.e. other than the UK govt)	In house on a 'buy and hold basis' and Fund Managers
Collateralised deposits	In house and fund managers
Property fund: ***the use of these investments would constitute capital expenditure***	Fund manager
1. Bond Funds	In-house and Fund Managers
2. Gilt Funds	In-house and Fund Managers
Collective Investment Schemes structured as Open Ended Investment Schemes	
Bond Funds	In-house and Fund Managers
Gilt Funds	In-house and Fund Managers

7.8 The Director of Resources will continue to monitor the range of investment instruments available and make changes to the list as appropriate.

8 Policy on Interest Rate Exposure

8.1 As required by the Prudential Code, the Council must approve before the beginning of each financial year the following treasury limits:

a) the overall borrowing limit;

b) the amount of the overall borrowing limit which may be outstanding by way of short term borrowing;

c) the maximum proportion of interest on borrowing which is subject to variable rate interest.

8.2 The Director of Resources is responsible for incorporating these limits into the Annual Treasury Management Strategy, and for ensuring compliance with the limits. Should it prove necessary to amend these limits, the Director of Resources shall submit the changes for approval to the Executive Board before submission to the full Council for approval.

9 Policy on External Managers

9.1 The Council has taken the view that the appointment of external fund managers would not provide an enhanced return over what could be achieved by managing investment in house.

9.2 However, the fact that a fund manager's expertise allows for a wider investment portfolio than would be operated by Council officers may give opportunities for capital gains to supplement interest earned on investment of revenue balances.

9.3 It is felt appropriate therefore that the Policy allows for the use of external fund managers and although none are being used at present, this situation will be kept under review. Appointment of a fund manager would take place following a tender exercise and submissions on target performance.

10 Policy on Delegation and Review Requirements and Reporting Arrangements

10.1 The Council is responsible for determining the borrowing limits detailed in section 8 above. Other responsibilities and duties are delegated as follows.

10.2 The Executive Board has responsibility for determining and reviewing treasury strategy and performance. (See section 5 above).

10.3 The Director of Resources and through him/her to his/her staff has delegated powers for all borrowing and lending decisions. This delegation is required in order that the authority can react immediately to market interest rate movements and therefore achieve the best possible terms. The Director of Resources and staff will operate in accordance with the Code of Practice for Treasury Management in Local Authorities.

10.4 Delegation within the Department of Resources operates on the following basis and is summarised in Annexe B:

a) The practical organisation within the Resources Department is that all aspects of borrowing/lending strategy over the year are determined or reported to regular monthly meetings of the Finance Performance Group attended by the Director of Resources and Chief Officer (Financial Development). Quarterly, treasury strategy review meetings take place with the Principal Finance Manager and Treasury Manager.

b) Implementation of decisions at such meetings and the day to day management of the Treasury Operations are delegated without limit to the Chief Officer (Financial Development) and through him/her, or in his/her absence, to either the Principal Finance Manager or the Treasury Manager and on occasions the Assistant Finance Manager.

c) Consultations will be made by the Director of Resources on Treasury Management matters with:

- The Chief Executive: so that he/she can ensure proper Treasury systems are in place and are properly resourced.

- External Treasury Advisers : so that they can advise and monitor the process of fixing strategy and policy on Treasury Matters and advise on the economic outlook, prospects for interest rates and credit worthiness

FITCH CREDIT RATING DEFINITIONS

Source: Fitch Ratings

International Short-Term Credit Ratings

A short-term rating has a time horizon of less than 12 months for most obligations, or up to three years for US public finance securities, and thus places greater emphasis on the liquidity necessary to meet financial commitments in a timely manner.

FI *Highest credit quality*. Indicates the strongest capacity for timely payment of financial commitments; may have an added "+" to denote any exceptionally strong credit feature.

F2 *Good credit quality*. A satisfactory capacity for timely payment of financial commitments, but the margin of safety is not as great as in the case of the higher ratings.

F3 *Fair credit quality*. The capacity for timely payment of financial commitments is adequate; however, near-term adverse changes could result in a reduction to non-investment grade.

B *Speculative*. Minimal capacity for timely payment of financial commitments, plus vulnerability to near-term adverse changes in financial and economic conditions.

C *High default risk*. Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon a sustained, favourable business and economic environment.

D *Default.* Denotes actual or imminent payment default. “+” or “-“may be appended to a rating to denote relative status within major rating categories. Such suffixes are not added to the 'AAA’ long-term rating category, to categories below 'CCC', or to short-term ratings other than 'FI'.

International Long-Term Credit Ratings Investment Grade

AAA *Highest credit quality*. 'AAA' ratings denote the lowest expectation of credit risk. They are assigned only in case of exceptionally strong capacity for timely payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.

AA *Very high credit quality*. 'AA' ratings denote a very low expectation of credit risk. They indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.

A *High credit quality*. 'A' ratings denote a low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings.

BBB *Good credit quality*. 'BBB' ratings indicate that there is currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity. This is the lowest investment-grade category.

Speculative Grade

BB *Speculative*. 'BB' ratings indicate that there is a possibility of credit risk developing, particularly as the result of adverse economic change over time; however, business or financial alternatives may be available to allow financial commitments to be met. Securities rated in this category are not investment grade.

B *Highly speculative*. 'B' ratings indicate that significant credit risk is present, but a limited margin of safety remains. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favourable business and economic environment.

CCC, CC *High default risk*. Default is a real possibility. Capacity for meeting and C financial commitments is solely reliant upon sustained, favourable business or economic developments. A 'CC' rating indicates that default of some kind appears probable. 'C' ratings signal imminent default.

DDD, DD *Default*. The ratings of obligations in this category are based on and D their prospects for achieving partial or full recovery in a reorganisation or liquidation of the obligor. 'DDD' designates the highest potential for recovery of amounts outstanding on any securities involved. 'DD' indicates expected recovery of 50% - 90% of such out standings, and 'D' the lowest recovery potential, i.e. below 50%.

Individual Ratings

Fitch's Individual Ratings attempt to assess how a bank would be viewed if it were entirely independent and could not rely on external support. These ratings are designed to assess a bank's exposure to, appetite for, and management of risk and thus represents Fitch's view on the likelihood that it would run into significant difficulties such that it would require support.

A A very strong bank. Characteristics may include outstanding profitability and balance sheet integrity, franchise, management, operating environment, or prospects.

B A strong bank. There are no major concerns regarding the bank. Characteristics may include strong profitability and balance sheet integrity, franchise, management, operating environment or prospects.

C An adequate bank which, however, possesses one or more troublesome aspects. There may be some concerns regarding its profitability and balance sheet integrity, franchise, management, operating environment or prospects.

D A bank which has weaknesses of internal and/or external origin. There are concerns regarding its profitability and balance sheet integrity, franchise, management, operating environment or prospects .

E A bank with very serious problems which either requires or is likely to require external support.
Note: In addition, FITCH uses gradations among these five ratings, i.e AIB, BIC, CID, and DIE.

Support Ratings

Support/Legal Ratings do not assess the quality of a bank. Rather, they are Fitch's assessment of whether it would receive support in the event of difficulties. Fitch emphasises that these ratings constitute their opinions alone - although they may discuss the principles underlying them with the supervisory authorities, the ratings given to banks are Fitch's own and are not submitted to the authorities for their comment or endorsement.

1 A bank for which there is an extremely high probability of external support. The potential provider of support is very highly rated in its own right and has a very high propensity to support the bank in question. This probability of support indicates a minimum Long-term rating floor of 'A-'.

2 A bank for which there is a high probability of external support. The potential provider of support is highly rated in its own right and has a high propensity to provide support to the bank in question. This probability of support indicates a minimum Long-term rating floor of 'BBB-'.

3 A bank for which there is a moderate probability of support because of uncertainties about the ability or propensity of the potential provider of support to do so. This probability of support indicates a minimum Long-term rating floor of 'BB-'.

4 A bank for which there is a limited probability of support because of significant uncertainties about the ability or propensity of any possible provider of support to do so. This probability of support indicates a minimum Long-term rating floor of 'B'.

5 A bank for which external support, although possible, cannot be relied upon. This may be due to a lack of propensity to provide support or to very weak financial ability to do so. This probability of support indicates a Long-term rating floor no higher than 'B-' and in many cases no floor at all.

It must be emphasised that in the Support rating Fitch is not analysing how "good" or "bad" a bank is, but merely whether in Fitch’s opinion it would receive support if it ran into difficulties.

DELEGATIONS IN RELATION TO TREASURY MANAGEMENT

FULL COUNCIL	EXECUTIVE BOARD	CORPORATE GOVERNANCE & AUDIT COMMITTEE	CENTRAL & CORPORATE FUNCTIONS SCRUTINY BOARD
Borrowing limits	Treasury Management Strategy	Adequacy of treasury Management policies and practices	Review / scrutinise any aspects of the Treasury management function
Changes to borrowing limits	Monitoring reports in year	Compliance with statutory guidance	
Treasury Management Policy	Performance of the treasury function		

DELEGATIONS TO OFFICERS

DELEGATION SCHEME	TO WHOM	FUNCTION DELEGATED
Officer delegation scheme (Executive Functions) (p186)	Director of Resources	Making arrangements for the proper administration of the authority's financial affairs
Sub delegation scheme (p21 App1 Corporate & S151 responsibilities)	Discharged through Chief Officers	Making arrangements for the proper administration of the authority's financial affairs
Sub delegation scheme (p24 executive Functions)	To Chief Officers in relation to areas within their remit	Making arrangements for the proper administration of the authority's financial affairs
Sub delegation scheme (p53 Financial Procedure Rules – Treasury Management)	Function discharged by Chief Officer Financial Development	Treasury Management function

OPERATIONAL AUTHORITY OF OFFICERS

POLICY DOCUMENT	TO WHOM	OPERATIONAL AUTHORITY
Treasury Management Policy (section 10)	- Chief Officer Financial Development - Principal Financial Manager - Treasury Manager - Assistant Finance Manager	Implementation of decisions taken at Treasury strategy review meetings and day to day management of treasury operations

Annexe B