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Report of Chief Officer Financial Development

Report to Corporate Governance and Audit Committee

Date: 9th November 2012

Subject: Treasury Management Governance Report

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?	☒ 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 annual report provides assurance that the Treasury Management function is operating within its governance framework. Treasury management has adopted and incorporated changes to the CIPFA Code of Practice and guidance notes and the Prudential Code. It has also updated its treasury management policy statement.

2. TM operates within the governance framework and also uses additional market intelligence and information gathered from a variety of sources. These sources have been integral in protecting the authority from undue risk in the financial and money markets.

3. Treasury Management is operating within its scheme of delegation and internal audit have provided substantial assurance on the control environment and compliance.

Recommendations

4. Note the delegations in respect to treasury management as outlined in Appendix A

5. Note that there is assurance that Treasury Management has adopted and is complying with the revised CIPFA Code of Practice and guidance notes and the Prudential Code.

6. Note that the Treasury Management Policy Statement has been updated.

1 Purpose of this report

1.1 This annual report outlines the governance framework for the management of the Council's Treasury Management (TM) function. This report also reviews compliance with the revised Chartered Institute of Public Finance and Accountancy (CIPFA) code of practice on treasury management and guidance notes and a revised prudential code. These were issued in November 2009 and revised 2011.

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.

2.2 TM is responsible for the Housing Revenue Account and General Fund long term debt in the region of £1.5bn and investments that currently stand at around £25m. It also manages the cash flow requirements of the Council.

2.3 Following the collapse of the Icelandic banks Corporate Governance and Audit Committee (CGA) were presented with a report on 12th November 2009 on the recommendations of three reports prepared by the Communities and Local Government Select Committee, the Audit Commission and CIPFA. Following these reports CIPFA issued a revised Treasury Management Code of Practice and guidance notes and a revised Prudential Code in 2009.

2.4 A further report was presented on 13th December 2011 to CGA and the committee noted the that the requirements of the revised CIPFA Code of Practice and Guidance Notes have been incorporated into Treasury Management practices and policies and that the Prudential Code has been adopted.

3 Main issues

3.1 Treasury management operates under a scheme of delegation and is shown in Appendix A

3.2 The role of the CGA Committee is to ensure that Treasury Management is adhering to and operating within its governance framework. This involves compliance with the revised Chartered Institute of Public Finance and Accountancy (CIPFA) code of practice on treasury management and guidance notes and a revised prudential code (2009 and 2011).

3.3 The revisions to these codes were reported in the Treasury Management Strategy 2012/13 Report to Executive Board on 10th February 2012. That report also confirmed that revisions were adopted by the Council. The changes are shown in Appendix B.

3.4 Executive Board also approved the update of the Treasury management policy 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 (Please see appendix C). The criteria for counter party investment has also been updated to reflect amended investment durations in Section 7.5 of Appendix C.

3.5 The operation of TM within its governance framework is also complimented by additional market intelligence and information gathered from a variety of sources. For example when the Icelandic crisis unfolded the Council had already reduced its investments in a number of banks, despite the rating agencies indicating that they were sound investments. These tools involve:

- The use of real time market information on the financial and money markets in the UK, Europe, US and other major economies;
- Discussions with market participants and brokers;
- Use of treasury advisors to test market views;
- Networking and sharing of information with Core Cities and West Yorkshire districts;
- Attending market seminars providing technical and economic updates;
- Daily market updates from financial institutions and brokers; and
- Thorough review of new financial products and how they fit within the governance structure.

3.6 TM will continue to use these additional measures and influence the national governance framework by providing responses to consultations. TM will also continue to review key aspects of the framework including prudential indicators to ensure that they continue to be fit for purpose and provide the right evidence that TM is operating within acceptable levels of risk.

3.7 Internal Audit has undertaken and concluded its annual review of the TM function. This involved a risk based system audit of TM to evaluate and validate key systems controls. Key controls for a sample of investments, loans and interest payments from 2011/12 were reviewed. Internal Audit provided two opinions:

- Control Environment - Substantial Assurance (highest level). This provides assurances that there are minimal control weaknesses that present very low risk to the control environment.

- Compliance with the Control environment - Substantial Assurance (highest level). This level indicates that the control environment has substantially operated as intended although some minor errors have been detected in the sample tested.

4 Corporate Considerations

4.1 Consultation and Engagement

4.1.1 CIPFA have consulted with all local authorities prior to the issue of the revised codes and the Council has participated in this consultation. There has been no further consultation in relation to this report

4.2 Equality and Diversity / Cohesion and Integration

4.2.1 This report does not have any direct equality and diversity/cohesion and integration issues.

4.2.2 An equality screening document is attached at Appendix D.

4.3 Council policies and City Priorities

4.3.1 The execution of treasury strategy enables cash funding to be raised and managed in the most efficient manner and this supports revenue and capital spend in line with City Priority Plans and the Council Business Plan.

4.4 Resources and value for money

4.4.2 Execution of treasury strategy enables funds to be raised and managed in the most efficient manner in line with the approved strategy as presented to Executive Board on 10th February 2012.

4.5 Legal Implications, Access to Information and Call In

4.5.1 The legislative framework which governs treasury management is outlined in section 2.1. This framework includes compliance with the CIPFA Treasury management code of practice and guidance notes and the prudential code.

4.5.2 The main changes to the revised CIPFA Treasury Management Code of Practice and guidance notes are highlighted in section 3 and have been adopted.

4.5.3 CIPFA have also issued a revised Prudential Code which primarily covers borrowing and prudential indicators. The revised code has also been adopted by the Council.

4.5.4 There are no legal or access to information issues arising from this report. The report is subject to call in.

4.6 Risk Management

4.6.1 As set out in the treasury management policy statement, treasury management activities are carried out within a risk management framework and the management of risk is key to securing and managing the Council's borrowing, lending and cash flow activities.

4.6.2 By complying with and adopting the CIPFA Treasury Management Code of Practice and the Prudential Code, assurance is given that arrangements are in place to manage risks effectively.

5 Conclusions

5.1 A revised CIPFA Treasury Management Code of Practice and Prudential Code have been formally adopted by the Council. This report confirms that the Council is complying within the revised codes and the internal audit of the function provides substantial assurance on control and compliance. The Treasury Management Policy Statement has also 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

6.1 Note the delegations in respect to treasury management as outlined in Appendix A

6.2 Note that there is assurance that Treasury Management has adopted and is complying with the revised CIPFA Code of Practice and guidance notes and the Prudential Code.

6.3 Note that the Treasury Management Policy Statement has been updated.

7 Background documents[1]

7.1 CIPFA Prudential Code 2011 Edition (hard copies available on the TM Team)

7.2 CIPFA Code of Practice and Cross-Sectoral Guidance Notes 2011 Edition (hard copies available on the TM Team).

[1] The background documents listed in this section are available to download from the Council's website, unless they contain confidential or exempt information. The list of background documents does not include published works.

Appendix A

DELEGATIONS IN RELATION TO TREASURY MANAGEMENT

FULL COUNCIL	EXECUTIVE BOARD	CORPORATE GOVERNANCE & AUDIT COMMITTEE	RESOURCES AND COUNCIL SERVICES 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) – execution of treasury strategy	Chief Officer Financial Development Principal Financial Manager Treasury Manager	Implementation of decisions taken at Treasury strategy review meetings and day to day management of treasury operations

Appendix B

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	Implemented

		arrangements to use such products to ensure that it fully understands those products.”	

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 " Services should be subject to regular competition which would usually be via a competitive tendering process."	Implemented
	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" 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)"	Implemented
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	Implemented

		department for communities and Local government. It is the HRACFR which will be compared to this limit.	

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 C

Treasury Management Policy Statement

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.

Background

1.2 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.*

1.3 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."

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

1.5 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.

1.6 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.

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

Objectives of Treasury Management

1.8 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.

1.9 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.

Approved Activities of the Treasury Management Operation

1.10 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.

1.11 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.

1.12 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;

Formulation of Treasury Management Strategy

1.13 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.

1.14 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).

1.15 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.

1.16 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.

Approved Methods and Sources of Raising Capital Finance

1.17 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.

1.18 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)

1.19 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.

Approved Instruments and Organisations for Investments

1.20 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.

1.21 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

1.22 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.

1.23 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.

1.24 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

1.25 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.

1.26 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

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

Policy on Interest Rate Exposure

1.28 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.

1.29 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.

Policy on External Managers

1.30 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.

1.31 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.

1.32 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.

Policy on Delegation and Review Requirements and Reporting Arrangements

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

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

1.35 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.

1.36 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.