BRIDGEND COUNTY BOROUGH COUNCIL

AUDIT COMMITTEE

9 DECEMBER 2010

REPORT OF THE HEAD OF PROPERTY AND FINANCE

HALF-YEAR TREASURY MANAGEMENT REPORT 2010/11

1. Purpose of the Report

1.1 The purpose of the report is to comply with the Council's Treasury Policy Statement 2010/11 approved by Council on 10 February 2010 which nominated Audit Committee to be responsible for ensuring the effective scrutiny of the Treasury Management Strategy and policies.

2. Connection to Corporate Improvement Objectives and Other Corporate Priorities

2.1 The Treasury Management Report is integral to the delivery of the Corporate Improvement Objectives as the allocation of resources determines the extent to which the corporate objectives can be delivered.

3. Background

3.1 The Chartered Institute of Public Finance and Accountancy 'Treasury Management in the Public Services: Code of Practice' which was revised in 2009, requires all local authorities to conduct a mid year review of its treasury management policies, practices and activities.

4. Current Situation

4.1 The Council produces quarterly monitoring reports to Cabinet, a half year and annual report to full Council. The half year report was approved by Council on 3 November 2010 (Appendix A) and includes a review of treasury activities from 1 April to 30 September 2010, Treasury Management and Prudential Indicators 2010/11 and a review of the Treasury Policy Statement 2010/11.

5. Effect upon Policy Framework & Procedural Rules

5.1 As required by Financial Procedure Rule 17.2, all investments and borrowing transactions have been undertaken in accordance with the Treasury Policy Statement 2010/11 as approved by Council.

6. Equality Impact Assessment

6.1 There are no implications in relation to age; disability; gender and transgender; race; religion or belief and non-belief; sexual orientation in this report.

7. Financial Implications

7.1 These are reflected in the body of the report.

8. Recommendations

8.1 It is recommended that Members:-

- Note the half year Treasury Management Report 2010/11

Allan Phillips
Head of Property and Finance
19 November 2010

Contact Officer: Karin Thomas
Loans & Investment Officer

Telephone: 01656 643312

E-mail: Karin.Thomas@bridgend.gov.uk

Postal Address: Bridgend County Borough Council
Property & Finance
Civic Offices
Bridgend
CF31 4WB

Background documents:

Treasury Policy Statement 2010/11

APPENDIX A

BRIDGEND COUNTY BOROUGH COUNCIL

REPORT TO COUNCIL

03 NOVEMBER 2010

REPORT OF THE SECTION 151 OFFICER

HALF-YEAR TREASURY MANAGEMENT REPORT 2010/11

1. Purpose of the Report

1.1 The purpose of the report is to:-

- comply with the requirement of the Chartered Institute of Public Finance and Accountancy 'Treasury Management in the Public Services: Code of Practice' (the Code) to report as part of a mid year review an overview of treasury activities;
- report on the projected Prudential Indicators for 2010/11 and seek approval for the revised limits for the Treasury Management Indicators 2010/11;
- report on the proposed changes to the Treasury Policy Statement 2010/11 and seek Council's approval

2. Connection to Corporate Improvement Objectives / Other Corporate Priorities

2.2 The Treasury Management Report is integral to the delivery of the Corporate Improvement Objectives as the allocation of resources determines the extent to which the corporate objectives can be delivered.

3. Background

3.1 The Council's Treasury Management activities are regulated by The Local Government Act 2003 which provides the powers to borrow and invest as well as providing controls and limits on this activity.

3.2 Statutory Instrument (SI) 3239 (W319) 2003, as amended, develops the controls and powers within the Act. This requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities and to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services.

3.3 The Council formally adopted the Code in April 2004 (and the changes to the Code in the 2009 revised edition) and the regulatory requirements which limit the level of risk associated with its treasury management activities. In particular, its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means that both its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

3.4 A primary requirement of the Code is the formulation and the agreement by the Council of a Treasury Policy Statement, which sets out the Council's and Chief Financial Officer's responsibilities, delegation, and reporting arrangements. Council approved the Treasury Policy Statement 2010/11 on 10 February 2010. Treasury management in this context is defined as:

"*The management of the organisation's investments and cash flows, its banking, money market and capital market transaction; the effective control of the risks associated with those activities; and the pursuit of optimum performance n consistent with those risks.*"

3.5 This report covers the following areas:

- The Council's treasury position for the period 1 April to 30 September 2010
- Borrowing and debt strategy 2010/11
- Borrowing outturn for the period 1 April to 30 September 2010
- Investment Strategy 2010/11
- Investment outturn for the period 1 April to 30 September 2010
- Risk Management
- Review of the Treasury Policy Statement 2010/11
- Treasury Management and Prudential Indicators 2010/11

4. Current Situation

4.1.1 The treasury position for 1 April to 30 September 2010:

		Principal As at 01/04/10 £m	Average Rate %	Principal As at 30/09/10 £m	Average Rate %
Fixed rate long term funding	PWLB*	72.86	4.74	72.69	4.73
	Market	4.00	7.47	4.00	7.47
Variable rate long term funding	PWLB*	-	-		
	Market (LOBO)	19.25	4.65	19.25	4.65
Total Long Term Borrowing**		**96.11**	**4.84**	**95.94**	**4.83**
Other Long Term Liabilities		24.38	-	**24.05**	-
Other Short Term Liabilities		1.39		**1.37**	
Total Other liabilities(details in section 4.1.3**)**		**25.77**	-	**25.42**	-
Short Term Borrowing (Fixed rate)		-	-	-	-
TOTAL DEBT		**121.88**		**121.36**	
Fixed**** rate investments		10.00	1.64	**19.00**	**0.77**
Variable rate investments		3.80	0.76	**8.00**	**0.74**
TOTAL INVESTMENTS***		**13.80**	**1.39**	**27.00**	**0.76**

* Public Works Loan Board (PWLB)

** Long term borrowing/ includes all loans with an initial term of 365 days or more and includes PWLB debt of £175k with less than a year to maturity at 01/04/10 of which £167k had been paid as at 30/09/10

*** The investment totals include instant access deposit accounts which are classed as “Cash Equivalents” in the Authority’s balance sheet in the Statement of Accounts

4.1.2 Details of the debt maturity of the £95.94m long term borrowing outstanding at 30 September 2010 are detailed in **Schedule A**. The £19.25m showing as maturing in 2054, relates to Lender’s Option Borrower’s Option (LOBO) loans which may be re-scheduled in advance of this maturity date. The LOBO rate and term may vary in the future depending upon the prevailing market rates, the lender exercising their option to increase rates at one of the bi-annual trigger points (the next trigger date being in January 2011) and therefore, the Authority being given the option to accept the increase or to repay the loan without incurring a penalty.

4.1.3 It should be noted that the accounting practice required to be followed by the Council requires financial instruments in the accounts (debt and investments) to be measured in a method compliant with International Financial Reporting

Standards (IFRS). The figures shown in the above table and throughout the report are based on the actual amounts borrowed and invested and so may differ from those in the Statement of Accounts which include accrued interest or are stated at fair value in different instances. The move to IFRS has also resulted in some leases coming onto the balance sheet and being reclassified as finance leases instead of operating leases and these figures are shown in the table above and throughout the report. However, there will be no budgetary impact as there will be compensating savings in the service budgets.

4.1.4 The other liabilities figure of £25.42m at 30 September 2010 includes £1.09m invested on behalf of Bridgend Football club to provide alternative facilities which is held in an Escrow account (money held in trust pending the fulfilment of conditions in a contract), £1.41m Invest to Save monies (three year interest free loan received from the Welsh Assembly Government) and £21.19m for the Authority's Public Finance Initiative (PFI) arrangement for the provision of a Secondary School in Maesteg and £1.45m in respect of Finance leases. The long term liabilities figure at 1 April 2010 has been updated to reflect the move to IFRS detailed above.

4.1.5 The services provided to the Council by Sterling Consultancy Services, the Council's Treasury Management Consultants, include:-

- A review of treasury management procedures and practices
- On-going debt management advice including advice on the timing of new borrowing and the restructuring of debt
- Investment advice including advice on the credit ratings of counterparties
- Economic and interest rate forecasting

4.2 Borrowing and Debt Strategy for 2010/11

4.2.1 <u>The Expectation for Interest Rates</u>

The interest rate views, incorporated in the Council's Treasury Policy Statement for 2010/11, were based upon officers' views supported by a selection of City forecasts provided by Sterling, our Treasury Management Advisers.

The UK is currently in the longest, if not the deepest recession since World War Two. The new government is expected to cut spending and raise taxes, slowing the country's economic recovery. The scope for short-term interest rate rises in 2010/11 is limited. Bank Rate could remain at 0.5% for the whole of 2010, increasing quite rapidly thereafter into 2012, but remaining below levels prior to the recession.

4.2.2 The Adopted Borrowing and Debt Strategy 2010/11

The agreed strategy put to Council based on the above forecast was that due to the growing uncertainty over interest rates, the risks associated with treasury activity were increased. As a result, the Council would take a cautious approach to its treasury strategy.

The Section 151 Officer, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks forecast. Longer term fixed rates will be considered if borrowing levels remain relatively low.
The Council assumed long term borrowing rates of 4.60% in the Treasury Policy Statement for 2010/11.

4.3 Borrowing Outturn for 1 April to 30 September 2010

4.3.1 The base rate started the financial year at 0.50% and remained at that level from 1 April to 30 September 2010. It is forecast that it will remain at that level during the remainder of the financial year.

4.3.2 No long term borrowing has been taken during the period 1 April to 30 September 2010, however, short term (or temporary) borrowing was undertaken and subsequently repaid in April 2010 to cover shortfalls in cash due to timing differences in expenditure payments and income received. As shown above in section 4.1.1, there was no short term borrowing outstanding at 30 September 2010.

4.4 Investment Strategy 2010/11

4.4.1 The purpose of the Investment Strategy is to set out the policies for giving priority to the security (protecting the capital sum from loss) and liquidity (keeping the money readily available for expenditure when needed) of the Council's investments. The Strategy deals with the credit ratings defined for each category of specified investments, the prudential use of non-specified investments and the liquidity of investments. The Council has regard to the Welsh Assembly Government's Guidance on Local Government Investments and CIPFA's Treasury Management in Public Services: Code of Practice and Cross Sectoral Guidance Notes ("CIPFA TM Code").

4.4.2 The Annual Investment Strategy incorporated in the Council's Treasury Policy Statement 2010/11 states which investments the Council may use for the prudent management of its treasury balances during the financial year under the heads of specified and non-specified investments.

4.4.3 The Council uses credit ratings published by Fitch Ratings Ltd, Standard & Poor's and Moody's Investors Service to establish the credit quality of counterparties and investment schemes and decides its decision based on the lowest rating. In the current climate, relying mainly on credit ratings is considered to be inappropriate and the selection of suitable counterparties includes other factors, for example whether the counterparty has any explicit or implicit government support. This has been endorsed by the revised edition of the Treasury Management Code of Practice and WAG's Guidance on Local Authority Investments which states that authorities should not place an over-reliance on credit ratings.

4.4.4 A half year review of the Annual Investment Strategy will be undertaken and any changes will be reported to Council.

4.5 Investment Outturn for 1 April to 30 September 2010

4.5.1 The Council potentially has surplus cash balances arising from the cash-flow e.g. timing differences between grants being received and making associated payments. These are invested on the market via brokers or direct with the institution or in instant access business reserve accounts. The Council usually invests for a range of periods dependent on cash flow requirements and the interest rates on offer having regard to the Investment Strategy.

4.5.2 The Council used its investment account with the UK Debt Management Office (DMO - Executive Agency of UK Government).The interest rates offered by this facility were lower than some other counterparties but this is commensurate with the high level of security and reduced risk offered. It provided another option when examining potential investments particularly during a time when security is more important than yield. Other investments were made with UK local authorities and UK Registered Banks and Building Societies.

4.5.3 As shown in section 4.1.1, the balance on investments at 30 September 2010 was £27.00m. Favourable cash flows have provided surplus funds for investment and all these investments were either held with UK registered banks or building societies, local authorities or the DMO. Of these funds £6m was held on an instant access basis for cash flow purposes, £2m was held in a 15 day notice deposit account and the remaining balance held in fixed deposits maturing during the financial year. Included in this figure is £1.09m invested on behalf of Bridgend Football club to provide alternative facilities which is held in an Escrow account (money held in trust pending the fulfilment of conditions in a contract).

4.5.4 At 30 September 2010 the base rate was 0.50% and the average rate on our investments was 0.76%.

4.6 Risk Management

4.6.1 The Council's primary objective for the management of its investments is to give priority to the security and liquidity of its funds before seeking the best rate of return. The majority of its surplus cash is therefore held as short term investments with the UK Government and highly rated UK registered banks and building societies as detailed above. This has therefore resulted in more of our investment portfolio being moved into investment instruments with lower rates of return but higher security and liquidity, resulting in a fall in total investment earnings compared to previous years.

4.6.2 The Council's primary objective for the management of its debt is to ensure its long term affordability. The majority of its loans have therefore been borrowed from the Public Works Loan Board at long term fixed rates of interest.

4.7 Review of the Treasury Policy Statement 2010/11

4.7.1 Cipfa's Revised Code of Practice for Treasury Management requires all local authorities to conduct a mid year review of its treasury management policies, practices and activities. As a result of this review it was not deemed necessary to make many changes to the main parts of the Treasury Management Policy Statement 2010/11, however, it would be beneficial for the Council to make some revisions to the Investment Strategy included within this Statement (section 4 of the Treasury Policy Statement – extract shown in **Schedule C**). This would enable increased flexibility in an ever changing financial market and would increase the investment opportunities available to the Council.

4.7.2 Following consultation with the Council's Treasury advisers, the main proposed changes to the **Investment Strategy 2010/11** are detailed below. An extract of the revised Investment Strategy 2010/11 incorporating all the proposed changes is shown in **Schedule D**:

- The long term investments with UK central government, UK local authorities or banks and building societies category limit to be increased from £10m to £15m but in order to maintain the security of capital and liquidity of investments specific credit rating criteria and time limits will be introduced (section 4.13)

- The Non- Specified Investment limit to be increased from £15m to £20m to facilitate the change to long term investments above (applicable to sections 4.6 & 4.13)

- To facilitate overnight deposits for cash flow purposes, instant access deposits with the Council's bankers will be introduced up to a limit of £3m (currently Co-Operative Bank) even if they fall below the specified investment criteria but they will be classed as non-specified investments (section 4.13).

- Non-specified investments will include banks owned and domiciled in foreign countries with sovereign credit ratings no lower than AA+ with a time limit of 6 months (category limit £3m) (section 4.13)

- Non-specified investments will only be entered into with prior advice from the Council's Treasury Management Advisers - to be amended so that this only applies to investments longer than 364 days (section 4.14)

The other changes to the Treasury Policy Statement are:

- **Section 10 Reporting Arrangements** – the annual report will be made as soon as possible after the end of the financial year

- **Authorised Signatory List for Treasury Management** – the Financial Manager in the Financial Control Team Management will be added as an additional signatory in order to provide appropriate absence cover

- Changes to the limits set for the Treasury Management Indicators for 2010/11 as detailed in **Schedule B**

4.8 Treasury Management & Prudential Indicators 2010/11

4.8.1 The revised Treasury Management Code and Prudential Code requires the Council to set and report on a number of Treasury Management Indicators however the authority has decided to also report the remaining Prudential Indicators within this report. Details are shown in **Schedule B** of the original estimate for 2010/11 set out in the Council's Treasury Policy Statement as well as the proposed changes to the limits set for the Treasury Management Indicators and also the projected indicators for the Prudential Indicators

2010/11. These Indicators are required to be set and approved by Council in accordance with the Prudential Code.

5. Effect upon Policy Framework & Procedure Rules

5.1 As required by Financial Procedure Rule 17.2, all investments and borrowing transactions have been undertaken in accordance with the Treasury Policy Statement 2010/11 as approved by Council.

6. Equality Impact Assessment

6.1 There are no implications in relation to age; disability; gender and transgender; race; religion or belief and non-belief; sexual orientation in this report.

7. Financial Implications

7.1 The financial implications are reflected within the report.

8. Recommendation

8.1 It is recommended that:

- Council note the Authority's treasury management activities for the first half of 2010/11 and the projected Prudential Indicators 2010/11;

- Council approve the changes to the Treasury Policy Statement 2010/11 and the Treasury Management Indicators 2010/11 as endorsed by Cabinet on the 2 November 2010;

Allan Phillips
Section 151 Officer
Head of Property & Finance
15 October 2010

APPENDIX A

Contact Officer: Karin Thomas
Loans & Investment Officer

Telephone: 01656 643312

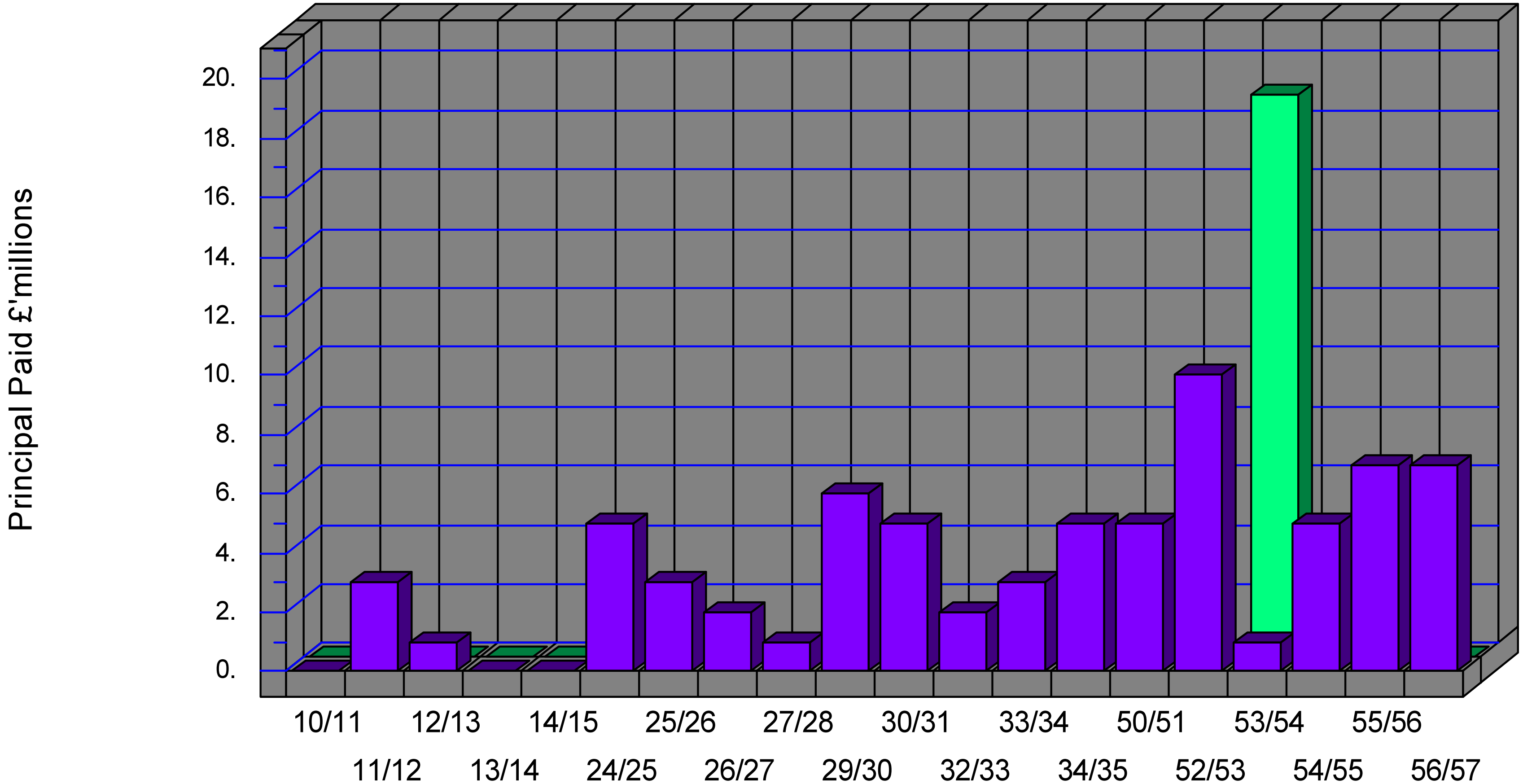
E-mail: Karin.Thomas@bridgend.gov.uk

Postal Address: Bridgend County Borough Council
Property & Finance
Civic Offices
Bridgend
CF31 4WB

Background documents:

Treasury Policy Statement 2010/11

MATURITY ANALYSIS - 2010 to 2057



1 TREASURY MANAGEMENT INDICATORS 2010/11

1.1 The following indicators now form part of the CIPFA Code of Practice on Treasury Management (Fully revised Second Edition 2009) however in previous years they were included with the Prudential Indicators. The first three limits have been revised to allow for the possible restructuring of PWLB debt if a favourable opportunity arose and for the debt to be replaced by variable PWLB debt if rates are expected to remain low.

The Council needs to set the upper limits to its exposure to the effects of changes in interest rates. There are two treasury management indicators that relate to both fixed interest rates and variable interest rates. These limits have been calculated with reference to the net outstanding principal sums. From 2010/11 to make the indicator easier to understand it has been decided to revise the presentation to show principal amounts rather than percentages.

No.		Treasury Policy Statement 2010/11 Upper £m	Revised Upper Limit 2010/11 £m
	Total Projected Principal Outstanding on Borrowing	105.93	105.93
	Total Projected Principal Outstanding on Investments	23.00	23.00
	Net Principal Outstanding	82.93	82.93
1.	**Limits on fixed interest rates (net principal) exposure**	106.00	106.00
2.	**Limits on variable interest rates Exposure (net principal) exposure**	25.00	**40.00**

The Section 151 Officer will manage interest rate exposures between these limits in 2010/11.

1.2 A further indicator for Treasury Management is the amount of projected borrowing that is fixed rate, maturing in each period as a percentage of total projected fixed rate borrowing.

No	Maturity structure of fixed rate borrowing during 2010/11	Upper limit	lower limit	Revised Upper Limit 2010/11
3.	Under 12 months	25%	0%	**50%**
	12 months and within 24 months	25%	0%	25%
	24 months and within 5 years	50%	0%	50%
	5 years and within 10 years	60%	0%	60%
	10 years and above	100%	40%	100%

1.3 The **Upper Limit for Total Principal Sums invested for more than 364 days** indicator controls the amount of longer term investments which mature beyond the period end. This has been increased from £10m to £15m to reflect the long term category limit increase in the Investment Strategy as detailed in section 4.7.

No.		Treasury Policy Statement 2010/11 £m	Revised Limit 2010/11 £m
4.	**Upper Limit for Total Principal Sums Invested for more than 364 days**	10	**15**

2 PRUDENTIAL INDICATORS 2010/11

The Prudential Indicators are required to be set and approved by Council in accordance with the Prudential Code. Council is also required to formally adopt CIPFA's Treasury Management Code (2009 revised edition).

The following Prudential Indicators are based on the Authority's capital programme which is subject to change.

2.1 Prudential Indicators for Prudence

2.1.1 The Council's capital expenditure plans are summarised below and this forms the first prudential indicator for Prudence. The total capital expenditure is funded from capital grants and contributions, capital receipts and revenue with the remainder being the **Net Financing Need for the Financial Year** to be met from borrowing.

No.	Prudential indicators For Prudence	Estimate Treasury Policy Statement 2010/11 £'000	Projection 2010/11 £'000
1	**Estimates of Capital Expenditure** Non – HRA	29,131	**32,722**
	Total Capital Expenditure	29,131	**32,722**
	Financed by :-		
	Capital Grants and Contributions	8,488	**12,840**
	Capital Receipts	8,024	**6,721**
	Revenue	0	**539**
	Net Financing Need for Year	12,619	**12,622**

The capital expenditure figures have changed from the Treasury Policy Statement 2010/11 as the capital programme approved by Council on 10 February 2010 has been amended to incorporate budgets carried from 2009/10, any new grant approvals and also budgets which are expected to slip into 2011/12.

2.1.2 The second Prudential Indicator is the **Capital Financing Requirement (CFR)** for the Council. This shows the total outstanding capital expenditure that has not been funded from either revenue or other capital resources. It is derived from the actual Balance Sheet of the Council. It is essentially a measure of the underlying need to borrow for capital purposes and forms the basis of the charge to the General Fund under the Prudential Code system.

The process for charging the capital expenditure to revenue is a statutory requirement and is called the Minimum Revenue Provision (MRP).The actual MRP charge needs to be prudent - the Council has deemed this to be set at 4% of the opening Capital Financing Requirement after adjustments. In addition to this, for all unsupported borrowing exercised under the Prudential Code (used to fund the purchase of assets for directorates) the MRP policy is based on the Asset Life Method. The Voluntary Revenue Provision (VRP) will be at equal annual instalments over the life of the asset which is met from existing revenue budgets. The first charge will be delayed until the asset is operational. The MRP requirement for the PFI Scheme and Finance Leases will be equivalent to the write down of the liability for the year and this is met from existing budgets.

No.	Prudential indicators For Prudence	Est. Treasury Policy Statement 2010/11 £'000	Projection 2010/11 £'000
2	**Capital Financing Requirement (CFR)**		
	Opening CFR (1 April 2010) excluding PFI	134,378	**133,762**
	Opening PFI CFR	-	**21,362**
	Opening Finance Lease CFR	-	**1,605**
	Total Opening CFR	134,378	**156,729**
	Movement in CFR excluding PFI & other liabilities	7,142	**7,132**
	Movement in PFI CFR	-	**(353)**
	Movement in Finance Lease CFR	-	**(307)**
	Total Movement in CFR	7,142	**6,472**
	Closing CFR (31 March 2011)	141,520	**163,201**
	Movement in CFR represented by :-		
	Net Financing Need for Year (above)	12,619	**12,622**
	Minimum and Voluntary Revenue Provisions*	(5,477)	**(6,150)**
	Total Movement	7,142	**6,472**

*Minimum Revenue Provision (MRP) and Voluntary Revenue Provision represent the revenue charge for the repayment of debt and includes £353k for the Public Finance Initiative (PFI) and £307k for Finance Leases

The reason for the large difference in the Capital Financing Requirement figures above is due to the PFI and Finance Leases under IFRS coming on balance sheet as detailed in section 4.1.3 of the report.

2.1.3 The Council's borrowing at the 30 September 2010 was £95.94m as detailed in section 4.1.1 the Treasury Position. External Borrowing can arise as a result of both capital and revenue expenditure. This is because the Council has an integrated Treasury Management Strategy where there is no association between individual loans and particular types of expenditure. Therefore, the Capital Financing Requirement and actual external borrowing can be very different.

The **Net External Borrowing** position (Borrowing net of Investments) is shown below.

No.	Prudential indicators For Prudence	Estimate Treasury Policy Statement 2010/11 £'000	Projection 2010/11 £'000
3	**Net External Borrowing**		
	External Borrowing	105,930	**105,930**
	External Investments (including instant access deposits)	23,000	**23,000**
	Total Net External Borrowing	82,930	**82,930**

The above figures include long term borrowing for 2010/11 which has not yet been taken.

2.2 Limits to Borrowing Activity

2.2.1 Within the Prudential Indicators, there are a number of key indicators to ensure the Council operates its activities within well-defined limits. One key control is to ensure that over the medium term, net borrowing will only be for a capital purpose. The Council needs to ensure that the Net External Borrowing does not, except in the short term, exceed the Capital Financing Requirement for 2010/11. The table below shows that the Council is on target to comply with this requirement.

No.	Prudential indicators For Prudence	Estimate Treasury Policy Statement 2010/11 £'000	Projection 2010/11 £'000
4	**Net Borrowing & the CFR**		
	Total Net External Borrowing	82,930	**82,930**
	Closing CFR (31st March)	141,520	**163,201**

2.2.2 A further two Prudential Indicators control the Council's overall level of borrowing to support Capital Expenditure. These are detailed below:-

- The Authorised Limit for External Debt – this represents the limit beyond which borrowing is prohibited. It reflects a level of borrowing that could not be sustained even though it would be affordable in the short term. It needs to be set and approved by Members.

- The Operational Boundary for External Debt – this is not an actual limit and actual borrowing could vary around this boundary during the year. It is based on the probable external debt during the course of the year.

No.	Prudential indicators For Prudence	Treasury Policy Statement 2010/11 £m	Projection 31/03/11 2010/11 £m
5	**Authorised limit for external debt -**		
	Borrowing	130	
	Other long term liabilities	30	
	Total	**160**	
6	**Operational Boundary**		
	Borrowing	110	
	Other long term liabilities	24	
	Total	**134**	
	Borrowing		**106**
	Other long term liabilities		**24**
	Total		**130**

2.3 Prudential Indicators for Affordability

2.3.1 The Prudential Code Indicators Numbered 1 to 6 covers the overall controls on borrowing and financing of capital expenditure within the Council. The second suite of indicators detailed below assesses the affordability of capital investment plans and the impact of capital decisions on the Council's overall finances.

The indicator the **Ratio of Financing Costs to Net Revenue Stream** demonstrates the trend in the cost of capital against the Total Revenue amount to be met from local taxpayers and the amount provided by the Assembly in the form of Revenue Support Grant. The estimates of capital financing costs include interest payable and receivable on Treasury Management activities and the Minimum Revenue Provision charged to the Consolidated Revenue Account. The revenue stream is the amount to be met from government grants and local taxpayers.

No.	Prudential Indicators for Affordability	Estimate Treasury Policy Statement 2010/11 £'000	Projection 2010/11 £'000
7.	**Ratio of Financing Costs to Net Revenue Stream**		
	Ratio	4.31%	5.20%

2.3.2 The indicator of the **Incremental Impact of Capital Investment Decisions on Council Tax** identifies the incremental impact to the Council Tax from the capital expenditure proposals, particularly changes in borrowing requirements that have occurred since the Capital Programme was approved for the year. This is a purely notional calculation designed to show the effect of changes in capital investment decisions

No.	Incremental Impact of Capital Investment Decisions on Council Tax	Estimate Treasury Policy Statement 2010/11	Projection 2010/11
8.	Increase in Band D Council Tax as per Capital Programme	£ 2.09	£ 2.09

Extract from Treasury Policy Statement 2010/11
(Approved by Council 10th February 2010)

4.0 INVESTMENT STRATEGY 2010/11 - 2012/13

4.1 The purpose of the Investment Strategy is to set out the policies for giving priority to the security (protecting the capital sum from loss) and liquidity (keeping the money readily available for expenditure when needed) of the Council's investments. The Strategy deals with the credit ratings defined for each category of specified investments, the prudential use of non-specified investments and the liquidity of investments. The Council has regard to the Welsh Assembly Government's Guidance on Local Government Investments (Draft January 2010) and CIPFA's Treasury Management in Public Services: Code of Practice and Cross Sectoral Guidance Notes ("CIPFA TM Code").

4.2 This Annual Investment Strategy states which investments the Council may use for the prudent management of its treasury balances during the financial year under the heads of **Specified Investments** and **Non-Specified Investments.**

4.3 A **Specified Investment** is one which offers high security and high liquidity. It is a low risk investment where the possibility of loss of principal or investment income is negligible and satisfies the conditions below (extract WAG Guidance on Local Government Investments- draft January 2010):-

- The investment is denominated in sterling and any payments or repayments of the investment are payable only in sterling.
- The investment is not a long-term investment (contractually committed to be paid within 12 months).
- The making of the investment is not defined as capital expenditure by virtue of regulation 20(1)(d) of the Local Authorities (Capital Finance and Accounting)(Wales) Regulations 2003 [SI 3239 as amended].
- The investment is made with a body or in an investment scheme of high credit quality; or with one of the public sector bodies:
    i. the UK Government;
    ii. or a local authority in England or Wales (as defined in section 23 of the 2003 Act) or similar body in Scotland or Northern Ireland;
    iii. a parish council or community council.

4.4 High credit quality is deemed to be Banks and building societies holding long-term credit ratings no lower than A+ or equivalent; or those holding the highest possible short-term credit ratings (F1+ or equivalent); UK building societies not meeting the previous two criteria that have been issued an eligibility certificate under the UK Government Credit Guarantee Scheme; UK Central Government and UK Local Authorities.

It is proposed that specified investments comprise of the following institutions:

- UK & UK Registered Banks and Building Societies with a high credit quality
- Debt Management Account Deposit Facility (DMADF)
- UK Local Authorities

4.5 Building societies are mutually owned financial institutions with a more cautious business model than shareholder owned banks. They are tightly regulated by the Financial Services Authority, which detects problems at an early stage and has encouraged several mergers between societies recently. The probability of a building society defaulting on its financial obligations is therefore low. They operate under a separate legal regime to banks, which limits their lending and borrowing activities, and ranks wholesale deposits higher than individuals' savings in the unlikely event of an insolvency. This ensures that wholesale depositors would almost certainly receive the full value of their investment from a liquidation and the likely loss given default is therefore very low. While there are plans to revise the law in the future, the Treasury has indicated there will be full protection for existing depositors. The Council will review its investments in building societies if or when the law is changed.

4.6 A **Non-Specified Investment** is any investment that does not fall into the criteria detailed in 4.3 above. The WAG Guidance requires the Annual Investment Strategy to specify the types of investments that may be used during the financial year and the maximum amounts upper limits which may be held in each identified category and an overall limit for non-specified investments. This is currently set at a limit of £15m for a maximum of 5 years with fixed deposits with Banks/Building Societies as per the counterparty list (greater than 365 days).

<u>Investment Objectives</u>

4.7 All investments will be in sterling, thereby reducing the Council's exposure to the risks of currency fluctuations. The general policy objective for this Council is the prudent investment of its treasury balances. The Council's investment priorities are in the order of priority:

(a) the **security** of capital
(b) **liquidity** of its investments
(c) the **yield** of the funds

4.8 The Council will aim to achieve the yield on its investments commensurate with the proper levels of security and liquidity. This is consistent with the Welsh Assembly Government's draft Guidance on Local Government Investments (January 2010) and the Communities and Local Government 'Review of the local government investments guidance in England' (November 2009) which states that "investments priorities should be security and liquidity rather than yield".

4.9 The Welsh Assembly Government maintains that the borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity. The draft WAG Guidance on Local Authority Investments recommends that the Treasury Policy Strategy reports on the amount of investment of money borrowed in advance of need. This Authority's borrowing is however not linked to the financing of specific items of expenditure, therefore it would find it difficult to estimate this figure.

Credit Rating Criteria and their Use

4.10 This Council uses credit ratings published by Fitch Ratings Ltd, Standard & Poor's and Moody's Investors Service to establish the credit quality of counterparties (issuers and issues) and investment schemes and decides its decision based on the lowest rating. In the current climate, relying mainly on credit ratings is considered to be inappropriate and the selection of suitable counterparties will include other factors, for example whether the counterparty has any explicit or implicit government support. This has been endorsed by the revised edition of the Treasury Management Code of Practice and WAG's Guidance on Local Authority Investments (Draft January 2010) which states that authorities should not place an over-reliance on credit ratings.

4.11 In addition to investments in the DMADF and UK local authorities, the Council has taken a decision to limit investments to UK & UK Registered Banks and building societies. The Council has also determined the minimum long-term and short-term and other credit ratings it deems to be "high" for each category of investment.

Monitoring of credit ratings:

- The Authority receives a new Counterparty List for investment purposes from Sterling (Treasury Management Consultant) at the beginning of each month.
- All credit ratings will be monitored daily by Sterling who will notify the Council by email of any 'rating watch' notices which are acted upon immediately.

- If a counterparty's or investment scheme's rating is downgraded with the result that it no longer meets the Council's minimum criteria, the further use of that counterparty/investment scheme as a new investment will be withdrawn immediately and any investment that can be re-called at no cost will be re-called. Full consideration will be given to recall any other existing investments.

- If a counterparty is upgraded so that it fulfils the Council's criteria, it will be included in the Counterpart List.
- If there are other sources of information about a particular institution that comes to light and puts the credit-worthiness of that institution into doubt, the counterparty will be excluded from the Council's list. The Council will make use of generally available market information including financial press, market data, information on government support for banks and the credit ratings of that government support.
- Where a credit rating agency announces that it is actively reviewing an organisation's credit ratings with a view to downgrading it so that it is likely to fall below the Council's investment criteria, then investments will be restricted to only instant access investment until the outcome of the review is announced.

Investment Strategy to be followed in-house

4.12 Specified Investments
The majority of the Council's surplus funds will be kept in the form of short-term investments with:-

	Counterparty Limit £m
Banks and Building Societies holding long-term credit ratings no lower than A+ or equivalent (please see exception below)	5.0
Building Societies with an asset size less than £500 million	2.5
U.K. Local Authorities, parish councils and community councils	5.0
UK Central Government	No limit

4.13 Non-specified Investments

A maximum of £15m of investments could be in one of the following non-specified categories:-

- Money market funds rated AAA (category limit £5m)
- Long-term investments with UK central government, UK local authorities or banks and buildings societies with a minimum AA- or Aa3 long-term credit rating (total long-term limit £10m)

4.14 All investments longer than six months will only be entered into with prior advice from the Authority's Treasury Management Consultant (Sterling).

4.15 The Council does not employ external fund managers to manage the day-to-day Treasury Management activities.

4.16 Investments should be made only after the following steps have been taken:

(a) Assessment of the available funds and the suitability of the period over which the investment is to be made;

(b) Reference to the list of approved organisations and to the maximum limit on funds to be placed with a single organisation;

(c) The completion of adequate documentation to ensure the protection of the Council's interests;

(d) Checks to ensure that the interest rates offered are comparable with the other available investments;

(e) Due regard has been paid to the fact that a comparatively high return will usually entail a higher level of risk.

Investment balances/Liquidity of investments

4.17 Based on its cash flow forecasts, the Council anticipates its fund balances in 2010/11 to range from £18m to £45m. The actual balance varies because of the cash flow during the month as to when income is received (such as grants due, housing subsidy and Revenue Support Grant) and payments are made (such as salaries and wages, major capital expenditure and loan repayments). The actual balance also fluctuates during different parts of the financial year for example, spend on large capital projects being completed towards the last quarter of the financial year.

4.18 Any investment that the Council makes for a period in excess of 365 days will be made with a cautious approach to cash flow requirements.

Investments defined as Capital Expenditure

4.19 The acquisition of share capital or loan capital in any body corporate is defined as capital expenditure under Section 16(2) of the Local Government Act 2003.

Such investments will have to be funded out of capital or revenue resources and will be classified as 'non-specified investments'.

4.20 A loan or grant by the Council to another body for capital expenditure by that body is also deemed by regulation to be capital expenditure by this Council. It is therefore important for the Council to clearly identify if the loan has been made for policy reasons (e.g. to the registered social landlord for the construction/improvement of dwellings) or if it is an investment for treasury management purposes. The latter will be governed by the framework set by the Council for 'specified' and 'non-specified' investments.

Provisions for Credit-related losses

4.21 If any of the Council's investments appeared at risk of loss due to default (i.e. this is a credit-related loss and not one resulting from a fall in price due to movements in interest rates) the Council will make an impairment charge in accordance with accounting standards of an appropriate amount. An impairment charge would be applicable where it becomes probable that payments due under a contract will not be made, therefore, in terms of investments, a charge would be made to the Authority's accounts to reflect any potential loss in the financial year it occurred. This has not occurred and is not anticipated to occur during the financial year.

Investment Training

4.22 The Treasury Management Team receive training from the Authority's Treasury Management Consultants, CIPFA and other providers on current and potential future developments within treasury management. The Authority also supports personal development so individuals enhance their own knowledge through reading guidance, publications and research on the internet.

Investment consultants

4.23 The Council contracts with Sterling Consultancy Services to provide advice and information relating to its investment and borrowing activities. However, responsibility for final decision making remains with the Council and its officers. The services received include:

- advice and guidance on relevant policies, strategies and reports,
- advice on investment decisions,
- notification of credit ratings and changes,
- other information on credit quality,
- advice on debt management decisions,
- accounting advice,

- reports on treasury performance,
- forecasts of interest rates, and
- training courses.

The quality of this service is controlled by having regular meetings with the consultants. The contract was only initially given for a year and was only extended following an assessment of information that had been received and advice given throughout the first year of the contract.

Investment of money borrowed in advance of need

4.24 The Council may, from time to time, borrow in advance of spending need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks. The maximum periods between borrowing and expenditure is expected to be two years, although the Council does not link particular loans with particular items of expenditure.

Half Year Report and End of year Investment Report

4.25 At six months and at the end of the financial year, reports on the Authority's investment activity will be prepared and reported to Full Council.

Proposed Extract to be inserted Treasury Policy Statement 2010/11

4.0 INVESTMENT STRATEGY 2010/11 - 2012/13

4.1 The purpose of the Investment Strategy is to set out the policies for giving priority to the security (protecting the capital sum from loss) and liquidity (keeping the money readily available for expenditure when needed) of the Council's investments. The Strategy deals with the credit ratings defined for each category of specified investments, the prudential use of non-specified investments and the liquidity of investments. The Council has regard to the Welsh Assembly Government's Guidance on Local Government Investments 2010 and CIPFA's Treasury Management in Public Services: Code of Practice and Cross Sectoral Guidance Notes ("CIPFA TM Code").

4.2 This Annual Investment Strategy states which investments the Council may use for the prudent management of its treasury balances during the financial year under the heads of **Specified Investments** and **Non-Specified Investments.**

4.3 A **Specified Investment** is one which offers high security and high liquidity. It is a low risk investment where the possibility of loss of principal or investment income is negligible and satisfies the conditions below (extract WAG Guidance on Local Government Investments):-

- The investment is denominated in sterling and any payments or repayments of the investment are payable only in sterling.
- The investment is not a long-term investment (contractually committed to be paid within 12 months/364 days).
- The making of the investment is not defined as capital expenditure by virtue of regulation 20(1)(d) of the Local Authorities (Capital Finance and Accounting)(Wales) Regulations 2003 [SI 3239 as amended].
- The investment is made with a body or in an investment scheme of high credit quality; or with one of the public sector bodies:
    - (i) the UK Government;
    - (ii) or a local authority in England or Wales (as defined in section 23 of the 2003 Act) or similar body in Scotland or Northern Ireland;
    - (iii) a parish council or community council.

4.4 High credit quality is deemed to be UK and UK registered Banks and building societies holding long-term credit ratings no lower than A+ or equivalent; UK building societies not meeting the previous two criteria that have been issued an eligibility certificate under the UK Government Credit Guarantee Scheme; UK Central Government and UK Local Authorities.

It is proposed that specified investments comprise of the following institutions and limits are detailed below in section 4.12:

- UK & UK Registered Banks and Building Societies with a high credit quality
- Debt Management Account Deposit Facility (DMADF)
- UK Local Authorities

4.5 Building societies are mutually owned financial institutions with a more cautious business model than shareholder owned banks. They are tightly regulated by the Financial Services Authority, which detects problems at an early stage and has encouraged several mergers between societies recently. The probability of a building society defaulting on its financial obligations is therefore low. They operate under a separate legal regime to banks, which limits their lending and borrowing activities, and ranks wholesale deposits higher than individuals' savings in the unlikely event of an insolvency. This ensures that wholesale depositors would almost certainly receive the full value of their investment from a liquidation and the likely loss given default is therefore very low. While there are plans to revise the law in the future, the Treasury has indicated there will be full protection for existing depositors. The Council will review its investments in building societies if or when the law is changed.

4.6 A **Non-Specified Investment** is any investment that does not fall into the criteria detailed in 4.3 and 4.4 above. The WAG Guidance requires the Annual Investment Strategy to specify the types of investments that may be used during the financial year and the maximum amounts upper limits which may be held in each identified category and an overall limit for non-specified investments. This is currently set at a limit of £20m for a maximum of 5 years with fixed deposits with Banks/Building Societies as per the counterparty list. Details of the categories and limits are detailed in section 4.13.

<u>Investment Objectives</u>

4.7 All investments will be in sterling, thereby reducing the Council's exposure to the risks of currency fluctuations. The general policy objective for this Council is the prudent investment of its treasury balances. The Council's investment priorities are in the order of priority:

(d) the **security** of capital
(e) **liquidity** of its investments
(f) the **yield** of the funds

4.8 The Council will aim to achieve the yield on its investments commensurate with the proper levels of security and liquidity. This is consistent with the Welsh Assembly Government's Guidance on Local Government Investments and the Communities and Local Government 'Review of the local government investments guidance in England' (November 2009) which states that "investments priorities should be security and liquidity rather than yield".

4.9 The Welsh Assembly Government maintains that the borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity. The WAG Guidance on Local Authority Investments recommends that the Treasury Policy Strategy reports on the amount of investment of money borrowed in advance of need. This Authority's borrowing is however not linked to the financing of specific items of expenditure therefore it would find it difficult to estimate this figure.

Credit Rating Criteria and their Use

4.10 This Council uses credit ratings published by Fitch Ratings Ltd, Standard & Poor's and Moody's Investors Service to establish the credit quality of counterparties (issuers and issues) and investment schemes. The lowest common denominator (LCD) method is used to make decisions which means that the lowest available rating from the three agencies is used. In the current climate, relying mainly on credit ratings is considered to be inappropriate. Full regard will be given to other available information on the credit quality of banks and building societies, including credit default swap prices, and other factors such as whether the counterparty has any explicit or implicit government support. This has been endorsed by the revised edition of the Treasury Management Code of Practice and WAG's Guidance on Local Authority Investments which states that authorities should not place an over-reliance on credit ratings.

4.11 The Council has determined the minimum long-term, short-term and other credit ratings it deems to be "high" for each category of investment.

Monitoring of credit ratings:

- The Authority receives a new Counterparty List for investment purposes from Sterling (Treasury Management Consultant) at the beginning of each month.

- All credit ratings will be monitored daily by Sterling who will notify the Council by email of any 'rating watch' notices which are acted upon immediately.

- If a counterparty's or investment scheme's rating is downgraded with the result that it no longer meets the Council's minimum criteria, the further use of that counterparty/investment scheme as a new investment will be withdrawn immediately and any investment that can be re-called at no cost will be re-called. Full consideration will be given to recall any other existing investments.

- If a counterparty is upgraded so that it fulfils the Council's criteria, it will be included in the Counterpart List.
- If there are other sources of information about a particular institution that comes to light and puts the credit-worthiness of that institution into doubt, the counterparty will be excluded from the Council's list. The Council will make use of generally available market information including financial press, market data, information on government support for banks and the credit ratings of that government support.
- Where a credit rating agency announces that it is actively reviewing an organisation's credit ratings with a view to downgrading it so that it is likely to fall below the Council's investment criteria, then investments will be restricted to only instant access investment until the outcome of the review is announced.

Investment Strategy to be followed in-house

4.12 Specified Investments
The majority of the Council's surplus funds will be kept in the form of short-term investments with:-

	Counterparty Limit £m
UK & UK registered Banks and Building Societies holding long-term credit ratings no lower than A+ or equivalent & Building Societies with an asset size more than £500 million and member of Credit Guarantee Scheme	5.0
Building Societies with an asset size less than £500 million and member of Credit Guarantee Scheme	2.5
U.K. Local Authorities, parish councils and community councils	5.0
UK Central Government	No limit

4.13 Non-specified Investments

A maximum of £20m of investments could be in one of the following non-specified categories:-

- Instant access deposits with the Authority’s bankers even if they fall below the specified investment credit criteria (category limit £3m)
- Banks owned and domiciled in foreign countries with sovereign credit ratings no lower than AA+ (but still based on the lowest of the 3 credit rating agencies) with a time limit of 6 months(category limit £3m)
- Money market funds rated AAA (category limit £5m)
- Long-term investments with UK central government, UK local authorities or UK banks and buildings societies (category limit £15m):
  - Minimum AAA long term credit rating with a maximum time limit of 5 years
  - Minimum AA- or equivalent long term credit rating with a maximum time limit of 3 years
  - Minimum A+ or equivalent long term credit rating with a maximum time limit of 2 years

The combined value of short and long term investments with any one organisation are subject to the counterparty limits detailed in section 4.12 above.

4.14 All investments longer than 364 days will only be entered into with prior advice from the Authority’s Treasury Management Consultant (Sterling).

4.15 The Council does not employ external fund managers to manage the day-to-day Treasury Management activities.

4.16 Investments should be made only after the following steps have been taken:
(a) Assessment of the available funds and the suitability of the period over which the investment is to be made;
(b) Reference to the list of approved organisations and to the maximum limit on funds to be placed with a single organisation;
(c) The completion of adequate documentation to ensure the protection of the Council's interests;
(d) Checks to ensure that the interest rates offered are comparable with the other available investments;
(e) Due regard has been paid to the fact that a comparatively high return will usually entail a higher level of risk.

Investment balances/Liquidity of investments

4.17 Based on its cash flow forecasts, the Council anticipates its fund balances in 2010/11 to range from £18m to £45m. The actual balance varies because of the cash flow during the month as to when income is received (such as grants due, housing subsidy and Revenue Support Grant) and payments are made (such as salaries and wages, major capital expenditure and loan repayments). The actual balance also fluctuates during different parts of the financial year for example, spend on large capital projects being completed towards the last quarter of the financial year.

4.18 Any investment that the Council makes for a period in excess of 365 days will be made with a cautious approach to cash flow requirements.

Investments defined as Capital Expenditure

4.19 The acquisition of share capital or loan capital in any body corporate is defined as capital expenditure under Section 16(2) of the Local Government Act 2003. Such investments will have to be funded out of capital or revenue resources and will be classified as 'non-specified investments'.

4.20 A loan or grant by the Council to another body for capital expenditure by that body is also deemed by regulation to be capital expenditure by this Council. It is therefore important for the Council to clearly identify if the loan has been made for policy reasons (e.g. to the registered social landlord for the construction/improvement of dwellings) or if it is an investment for treasury management purposes. The latter will be governed by the framework set by the Council for 'specified' and 'non-specified' investments.

Provisions for Credit-related losses

4.21 If any of the Council's investments appeared at risk of loss due to default (i.e. this is a credit-related loss and not one resulting from a fall in price due to movements in interest rates) the Council will make an impairment charge in accordance with accounting standards of an appropriate amount. An impairment charge would be applicable where it becomes probable that payments due under a contract will not be made, therefore, in terms of investments, a charge would be made to the Authority's accounts to reflect any potential loss in the financial year it occurred. This has not occurred and is not anticipated to occur during the financial year.

Investment Training

4.22 The Treasury Management Team receive training from the Authority's Treasury Management Consultants, CIPFA and other providers on current and potential future developments within treasury management. The Authority also supports personal development so individuals enhance their own knowledge through reading guidance, publications and research on the internet.

Investment consultants

4.23 The Council contracts with Sterling Consultancy Services to provide advice and information relating to its investment and borrowing activities. However, responsibility for final decision making remains with the Council and its officers. The services received include:

- advice and guidance on relevant policies, strategies and reports,
- advice on investment decisions,
- notification of credit ratings and changes,
- other information on credit quality,
- advice on debt management decisions,
- accounting advice,
- reports on treasury performance,
- forecasts of interest rates, and
- training courses.

The quality of this service is controlled by having regular meetings with the consultants. The contract was only initially given for a year and was only extended following an assessment of information that had been received and advice given throughout the first year of the contract.

Investment of money borrowed in advance of need

4.24 The Council may, from time to time, borrow in advance of spending need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks. The maximum periods between borrowing and expenditure is expected to be two years, although the Council does not link particular loans with particular items of expenditure.

Half Year Report and End of year Investment Report

4.25 At six months and at the end of the financial year, reports on the Authority's investment activity will be prepared and reported to Full Council.