APPENDIX 1: Treasury Management Strategy Statement Annual Investment Strategy and Minimum Revenue Provision Policy Statement 2012/13

1. Introduction

1.1 Background

Treasury management is defined as:
"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans, which provide a guide to the borrowing need of the Council. Although the Council does not borrow to finance its capital spending plans, officers still plan and forecast the longer term cash flow position in order to ensure that the Council can meet its capital spending obligations and that it maintains balances (working capital) at a prudent and sustainable level.

1.2 Statutory and reporting requirements

The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals. These reports are required to be adequately scrutinised by committee before being recommended to the Council. This role is undertaken by the Executive & Resources Policy Development & Scrutiny Committee.

Prudential and Treasury Indicators and Treasury Strategy (this report) - This covers:
- the capital plans (including prudential indicators);
- a Minimum Revenue Provision Policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A Mid Year Treasury Management Report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision.

An Annual Treasury Report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

The Code also requires the Council to:

- Create and maintain a Treasury Management Policy Statement, which sets out the policies and objectives of the Council's treasury management activities.

- Create and maintain Treasury Management Practices, which set out the manner in which the Council will seek to achieve those policies and objectives.
- Delegate responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

1.3 Treasury Management Strategy for 2012/13

The proposed strategy for 2012/13 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser, Sector.

The strategy covers two main areas:

Capital Issues

- the capital plans and the prudential indicators;
- the MRP strategy.

Treasury management Issues

- the current treasury position;
- treasury indicators that will limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

2. The Capital Prudential Indicators 2012/13 to 2014/15

The Council's capital expenditure plans are the key driver of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members to overview and confirm capital expenditure plans.

Capital Expenditure. This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

Capital Expenditure	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
	£m	£m	£m	£m	£m
Adult & Community Services	7.4	8.5	4.4	2.9	1.0
Children & Young People	30.4	37.5	8.9	1.0	1.0
Environment	7.6	7.5	5.7	3.2	4.1
Renewal & Recreation	1.9	7.1	4.3	4.3	0.0
Resources	0.5	3.2	1.1	1.6	0.0
Sub-Total	**47.8**	**63.8**	**24.4**	**13.0**	**6.1**
Add: Service improvements	0.0	2.0	5.0	0.0	0.0
Add: Future new schemes	0.0	0.0	1.2	1.3	1.2
Less: Estimated slippage	0.0	-5.0	1.0	1.0	1.0
Grand Total	**47.8**	**60.8**	**31.6**	**15.3**	**8.3**

NB. The above financing need excludes other long term liabilities (finance lease arrangements), which already include borrowing instruments.

The table below shows how the above capital expenditure plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing).

Capital Expenditure	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
	£m	£m	£m	£m	£m
Total Expenditure	**47.8**	**60.8**	**31.6**	**15.3**	**8.3**
Financed by:					
Capital receipts	0.4	17.0	10.9	6.6	0.8
Capital grants/contributions	37.8	42.5	19.6	8.1	5.5
General Fund	0.0	0.0	0.0	0.0	1.5
Revenue contributions *	9.6	1.3	1.1	0.6	0.5
Net financing need	**47.8**	**60.8**	**31.6**	**15.3**	**8.3**

* These are approved contributions from the revenue budget, earmarked to fund specific schemes (primarily schools' schemes in 2011/12).

The Council's Borrowing Need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. If the CFR is positive, the Council may borrow from the Public Works Loans Board (PWLB) or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The Council's CFR has arisen from a combination of the internal "loan" made to the schools' budget to finance capital expenditure on special education (£3.2m outstanding at 31st March 2011) and liabilities arising from finance leases entered into in recent years in respect of various items of plant and equipment (£4.3m). The Council currently has no external borrowing as such. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The Council is asked to approve the CFR projections below:

CFR	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
	£m	£m	£m	£m	£m
Total CFR	**7.5**	**7.2**	**6.9**	**6.6**	**6.3**
Movement in CFR	**-0.3**	**-0.3**	**-0.3**	**-0.3**	**-0.3**

Movement in CFR represented by					
Net financing need for the year (above)	0.0	0.0	0.0	0.0	0.0
Less MRP/VRP and other financing movements	-0.3	-0.3	-0.3	-0.3	-0.3
Movement in CFR	**-0.3**	**-0.3**	**-0.3**	**-0.3**	**-0.3**

MRP Policy Statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to make additional voluntary payments (voluntary revenue provision - VRP).

CLG Regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision.

***The Council is recommended to approve the following MRP Statement**:*

MRP will be based on the estimated lives of the assets, in accordance with the regulations, and will follow standard depreciation accounting procedures. Estimated life periods will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

In practice, the Council's capital financing MRP is assessed as 4% of the outstanding balance on the internal borrowing that has been approved in respect of special education schemes. Annual repayments included in finance leases are also applied as MRP.

The Use of the Council's Resources and the Investment Position

The application of resources (capital receipts, reserves, etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales, etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
	£m	£m	£m	£m	£m
General Fund balance	27.8	27.8	27.8	27.8	26.3
Capital receipts	17.9	4.2	3.8	0.5	0.0
Capital grants	29.4	15.0	6.0	5.0	5.0
Provisions	7.2	8.0	8.0	8.0	8.0
Other (earmarked reserves)	49.0	43.0	39.0	39.0	39.0
Total core funds	**131.3**	**98.0**	**84.6**	**80.3**	**78.3**
Working capital*	39.3	52.2	65.4	65.9	63.1
Under/over borrowing**	0.0	0.0	0.0	0.0	0.0
Expected investments	**170.6**	**150.2**	**150.0**	**146.2**	**141.4**

*Working capital balances shown are estimated year end; these may be higher mid-year.

Affordability Prudential Indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

Actual and estimates of the ratio of financing costs to net revenue stream. This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
	%	%	%	%	%
Non-HRA	-2.6	-1.3	-1.5	-2.0	-2.0

Estimates of the incremental impact of capital investment decisions on Band D council tax. This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended to the Executive in February compared to the Council's existing approved commitments and current plans. Only a small proportion of the changes proposed will involve a contribution from Council resources and this will not impact on the level of Council Tax in future years. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
	£	£	£	£	£
Council tax - band D	-	-	-	-	-

3. Treasury Management Strategy

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current Portfolio Position

The Council's treasury portfolio position at 31 March 2011 is summarised below, together with forward projections. The table shows the actual external borrowing (the treasury management operations), against the capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£m	**2010/11 Actual**	**2011/12 Estimate**	**2012/13 Estimate**	**2013/14 Estimate**	**2014/15 Estimate**
	£m	**£m**	**£m**	**£m**	**£m**
External borrowing					
Borrowing at 1 April	3.2	2.9	2.6	2.3	2.0
Expected change in borrowing	-	-0.3	-0.3	-0.3	-0.3
Other long-term liabilities (OLTL)	4.3	4.3	4.3	4.3	4.3
Expected change in OLTL	-	-	-	-	-
Actual borrowing at 31 March	**-**	**-**	**-**	**-**	**-**
CFR – the borrowing need	**7.5**	**7.2**	**6.9**	**6.6**	**6.3**
Under / (over) borrowing	**7.5**	**7.2**	**6.9**	**6.6**	**6.3**
Investments	**170.6**	**150.2**	**150.0**	**146.2**	**141.4**
Total investments at 31 March					
Investment change	-	-20.4	-0.2	-3.8	-4.8
Net investments	**-163.1**	**-143.0**	**-143.1**	**-139.6**	**-135.1**

Within the prudential indicators, there are a number of key indicators to ensure that the Council operates its activities within defined limits. One of these is that the Council needs to ensure that its total borrowing, net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2012/13 and the following two financial years (shown as net borrowing above). This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Finance Director reports that the Council complied with this prudential indicator in the current year and does not envisage non-compliance in the future. This view takes into account current commitments, existing plans, and the proposals in this year's budget report.

3.2 Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary. This is the total figure that external borrowing is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual borrowing.

Operational boundary £m	**2011/12 Estimate**	**2012/13 Estimate**	**2013/14 Estimate**	**2014/15 Estimate**
Borrowing	10.0	10.0	10.0	10.0
Other long term liabilities	20.0	10.0	10.0	10.0
Total Operational Boundary	30.0	20.0	20.0	20.0

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

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
2. The Council is asked to approve the following Authorised Limit:

Authorised limit £m	**2011/12 Estimate**	**2012/13 Estimate**	**2013/14 Estimate**	**2014/15 Estimate**
	£m	£m	£m	£m
Borrowing	30.0	30.0	30.0	30.0
Other long term liabilities	30.0	30.0	30.0	30.0
Total Authorised Limit	60.0	60.0	60.0	60.0

3.3 Prospects for Interest Rates

The Council has appointed Sector as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Appendix 1 draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Sector central view.

Annual Average %	**Bank Rate**	**Money Rates**		**PWLB Borrowing Rates**		
		3 month	**1 year**	**5 year**	**25 year**	**50 year**
March 2012	0.50	0.70	1.50	2.30	4.20	4.30
June 2012	0.50	0.70	1.50	2.30	4.20	4.30
Sept 2012	0.50	0.70	1.50	2.30	4.30	4.40
Dec 2012	0.50	0.70	1.60	2.40	4.30	4.40
March 2013	0.50	0.75	1.70	2.50	4.40	4.50
June 2013	0.50	0.80	1.80	2.60	4.50	4.60
Sept 2013	0.75	0.90	1.90	2.70	4.60	4.70
Dec 2013	1.00	1.20	2.20	2.80	4.70	4.80
March 2014	1.25	1.40	2.40	2.90	4.80	4.90
June 2014	1.50	1.60	2.60	3.10	4.90	5.00

Growth in the UK economy is expected to be weak in the next two years and there is a risk of a technical recession (i.e. two quarters of negative growth). Bank Rate, currently 0.5%, underpins investment returns and is not expected to start increasing until quarter 3 of 2013 despite inflation currently being well above the Monetary Policy Committee inflation target. Hopes for an export-led recovery appear likely to be disappointed due to the Eurozone sovereign debt crisis depressing growth in the UK's biggest export market. The Comprehensive Spending Review, which seeks to reduce the UK's annual fiscal deficit, will also depress growth during the next few years.

Fixed interest borrowing rates are based on UK gilt yields. The outlook for borrowing rates is currently much more difficult to predict. The UK total national debt is forecast to continue rising until 2015/16; the consequent increase in gilt issuance is therefore expected to be reflected in an increase in gilt yields over this period. However, gilt yields are currently at historically low levels due to investor concerns over Eurozone sovereign debt and have been subject to exceptionally high levels of volatility as events in the Eurozone debt crisis have evolved.

This challenging and uncertain economic outlook has several key treasury mangement implications:

- The Eurozone sovereign debt difficulties, most evident in Greece, provide a clear indication of much higher counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2012/13;
- Borrowing interest rates are currently attractive, but may remain low for some time. The timing of any borrowing will need to be monitored carefully;
- There will remain a cost of capital – any borrowing undertaken that results in an increase in investments will incur a revenue loss between borrowing costs and investment returns.

3.4 Borrowing Strategy

The Council currently does not borrow to finance capital expenditure and finances all expenditure from external contributions, capital receipts or internal balances. Internal borrowing has been agreed, however, to finance a number of capital schemes, including SEN provision and other school capital works. A total of £3.2m of capital expenditure was left unfinanced at the end of 2010/11 in respect of the reprovision of special schools and, through the annual MRP, this is expected to reduce to around £2.9m by the end of 2011/12. This has resulted in the Council having a positive Capital Financing Requirement, effectively creating a need to borrow. In accordance with external advice, this is being treated as an internal advance, with repayments being met from the schools' budget with no impact on the Council's General Fund.

The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy and will monitor interest rates in financial markets.

Treasury Management Limits on Activity
There are three debt-related treasury activity limits. The purpose of these is to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive, they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;

- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;

- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

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

£m	2012/13	2013/14	2014/15
Interest rate Exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	20%	20%	20%
Maturity Structure of fixed interest rate borrowing 2012/13			
		Lower	**Upper**
Under 12 months (temporary borrowing only)		100%	100%
12 months to 2 years		N/A	N/A
2 years to 5 years		N/A	N/A
5 years to 10 years		N/A	N/A
10 years and above		N/A	N/A

3.5 Policy on Borrowing in Advance of Need

The Council will not borrow more than or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds. Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.6 Annual Investment Strategy

3.6.1 Investment Policy

The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.

In accordance with the above, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings and watches published by all three ratings agencies with a full understanding of what the ratings reflect in the eyes of each agengy. Using the Sector ratings service, banks' ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

Further, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets and of sovereign ratings. To this end, the Council will engage with its advisors to maintain a monitor on market pricing such as "Credit Default Swaps" and overlay that information on top of the credit ratings. This is encapsulated within the credit methodology provided by the advisors, Sector.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable divesification and thus avoidance of concentration risk.

The intention of the strategy is to provide security of investment and minimisation of risk.

3.6.2 Creditworthiness policy

Investment instruments identified for use in the financial year are listed in Annex 2 under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

Investment Counterparty Selection Criteria - The primary principles governing the Council's investment criteria are the security and liquidity of its investments, although the yield or return on the investment is also a key consideration. After these main principles, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections below; and

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

The Finance Director will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to those that determine which types of investment instrument are either Specified or Non-Specified as they provide an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

The rating criteria use the **lowest common denominator** method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one of which meets the Council's criteria, while the other does not, the institution will fall outside the lending criteria. This is in compliance with a CIPFA Treasury Management Panel recommendation in March 2009 and the CIPFA Treasury Management Code of Practice.

Credit rating information is supplied by Sector, our treasury consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum Council criteria may be suspended from use, with all others being reviewed in light of market conditions.

In addition, the Council receives weekly credit lists as part of the creditworthiness service provided by Sector. This service employs a sophisticated modelling approach utlilising credit ratings from the three main credit rating agencies - Fitch, Moodys and Standard and Poors. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS (Credit Default Swap) spreads to give early warning of likely changes in credit ratings (these provide an indication of the likelihood of bank default);
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties and a recommendation on the maximum duration for investments. The Council would not be able to replicate this level of detail using in-house resources, but uses this information, together with its own view on the acceptable level of counterparty risk, to inform its creditworthiness policy. The Council will also apply a minimum sovereign rating of AA+ to investment counterparties.

The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) are:

- **Banks 1** - good credit quality **–** the Council will only use banks which:
  a) are UK banks;
  b) are non-UK and domiciled in a country with a minimum long-term sovereign rating of AA+;
  c) have, <u>as a minimum</u>, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):

    - Short term – Fitch F1; Moody's P-1; S&P A-1
    - Long term – Fitch A-; Moody's A3; S&P A-

- **Banks 2** – Part nationalised UK banks – Lloyds Bank and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.

- **Bank subsidiary and treasury operation** - The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings in Banks 1 above.

- **Building societies** - The Council will use all societies that meet the ratings in Banks 1 above.

- **Money Market Funds –** The Council will use AAA-rated Money Market Funds.

- **UK Government** (including gilts and the DMADF)

- **Other Local Authorities, Parish Councils, etc.**

- **Supranational institutions**

The Council's detailed eligibility criteria for investments with counterparties are included in Annex 2.

All credit ratings will be continuously monitored. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

- if a downgrade results in the counterparty no longer meeting the Council's minimum criteria, its further use for new investments will be withdrawn immediately.
- in addition to the use of Credit Ratings, the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Further advice is also received from the Council's external cash manager, Tradition UK.

Sole reliance will not be placed on these external advisers. In addition, this Council will also use market data and market information, information on government support for banks and the credit ratings of that government support. The Council forms a view and determines its investment policy and actions after taking all these factors into account.

3.6.3 Country limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA+ from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). The list of countries that qualify using these credit criteria as at the date of this report is shown below. This list will be amended by officers should ratings change in accordance with this policy.

The Council may only place investments with counterparties in countries with sovereign ratings of AAA and AA+. Eligible countries are currently as follows:

AAA

- Australia
- Canada
- Denmark
- Finland
- France
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland
- U.K.

- U.S.A.

AA+

- Belgium
- Hong Kong

3.6.4 Investment Strategy

In-house funds: The Council's core portfolio is around £175m and cashflow variations during the course of the year have the effect from time to time of increasing the total investment portfolio to a maximum of around £210m. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Interest returns outlook: Bank Rate has been unchanged at 0.50% since March 2009 and is forecast to remain unchanged until Q3 of 2013, when it is expected to start to rise steadily. Bank Rate forecasts for financial year ends (March) are as follows:

- 2011/2012 0.50%
- 2012/2013 0.50%
- 2013/2014 1.25%
- 2014/2015 2.50%

There are downside risks to these forecasts (i.e. start of increases in Bank Rate is delayed even further) if economic growth remains weaker for longer than expected. However, should the pace of growth pick up more sharply than expected there could be upside risk, particularly if Bank of England inflation forecasts for two years ahead exceed the Bank of England's 2% target rate.

Sector's suggested budget for investment returns on investments placed for up to three months during each financial year is shown below, together with the assumptions made by the Council in the financial forecast, which are based on a longer average duration.

	Sector 3-month View	Council View
2012/13	0.70%	1.50%
2013/14	1.00%	1.50%
2014/15	1.60%	2.00%
2015/16	3.30%	2.50%
2016/17	4.10%	2.50%

Invesment treasury indicator and limit - total principal funds invested for greater than 364 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end. Under the proposed (and current) strategy, the only investments permitted for more than 1 year are to the part-nationalised banks, Lloyds TSB and RBS, each of which have a maximum exposure limit of £40m, so this indicator is set at £80m. In practice, the actual figure will be considerably less as we are currently restricting investments with these banks to 1 year.

The Council is asked to approve the treasury indicator and limit: -

As at year end	2011/12	2012/13	2013/14	2014/15
	£m	£m	£m	£m
Principal sums invested > 364 days	80.0	80.0	80.0	80.0

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

3.7 End of year investment report

After the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

3.8 External fund managers

£20m of the Council's funds are externally managed on a discretionary basis by Tradition UK. They are required to comply with the Annual Investment Strategy and are permitted to use specified and non-specified investments, subject to the Council's own counterparty eligibility criteria and lending limits. Their performance is closely monitored by the Finance Director and reported quarterly to the Resources Portfolio Holder and the Executive & Resources PDS Committee.

3.9 Policy on the use of external service providers

The Council uses Sector as its external treasury management advisors and Tradition UK as external cash fund managers.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

3.10 Scheme of delegation

(i) Full board/council

- receiving and reviewing reports on treasury management policies, practices and activities
- approval of annual strategy.

(ii) Boards/committees/council/responsible body

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices
- budget consideration and approval
- approval of the division of responsibilities
- receiving and reviewing regular monitoring reports and acting on recommendations
- approving the selection of external service providers and agreeing terms of appointment.

(iii) Body/person(s) with responsibility for scrutiny

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

3.11 Role of the section 151 officer

The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function

- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers.

ANNEXES

1. Economic background
2. Specified and non specified investments
3. Prudential Indicators – summary for approval by Council

ANNEX 1. Economic Background

4.1. Global economy

The outlook for the global economy remains clouded with uncertainty with the UK economy struggling to generate sustained recovery that offers any optimistim for the outlooks for 2011 and 2012, or possibly even into 2013. Consumer and business confidence levels are low and, with little to boost sentiment, it is not easy to see potential for a significant increase in the growth rate in the short term.

At the centre of much of the uncertainty is the ongoing **Eurozone sovereign debt crisis** which has intensified, rather than dissipated, throughout 2011. The main problem has been **Greece**, where, even with an Eurozone/IMF/ECB bailout package and the imposition of austerity measures aimed at deficit reduction, the lack of progress and the ongoing deficiency in addressing the underlying lack of competitiveness of the Greek economy, has seen an escalation of their problems. These look certain to result in a default of some kind but it currently remains unresolved if this will be either “orderly” or “disorderly”, and/or also include exit from the Euro bloc.

As if that were not enough there is growing concern about the situation in **Italy** and the risk that contagion has not been contained. Italy is the third biggest debtor country in the world but its prospects are limited given the poor rate of economic growth over the last decade and the lack of political will to address the need for fundamental reforms in the economy. The Eurozone now has a well established track record of always doing too little too late to deal with this crisis; this augurs poorly for future prospects, especially given the rising level of electoral opposition in northern EU countries to bailing out profligate southern countries.

The US economy offers little to lift spirits. With the next Presidential elections due in November 2012, the current administration has been hamstrung by political gridlock with the two houses split between the main parties. In quarter 3, the Federal Reserve started “Operation Twist” in an effort to re-ignite the economy in which growth is stalling. High levels of consumer indebtedness, unemployment and a moribund housing market are weighing heavily on consumer confidence and so on the abiltity to generate sustained economic growth.

Hopes for broad based recovery have, therefore, focussed on the **emerging markets** but these areas have been struggling with inflationary pressures in their previously fast growth economies. China, though, has maintained its growth pattern, despite tightening monetary policy to suppress inflationary pressures, but some forward looking indicators are causing concern that there may not be a soft landing ahead, which would then be a further dampener on world economic growth.

4.2 UK economy

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

Economic Growth. GDP growth has, basically, flatlined since the election of 2010 and, worryingly, the economic forcecasts for 2011 and 2012 have been revised lower on a near quarterly basis as the UK recovery has, effectively, stalled. With fears of a potential return to recession, the Bank of England embarked on a second round of Quantitative Easing to stimulate economic activity.

Unemployment. With the impact of the Government’s austerity strategy impacting the trend for 2011 of steadily increasing unemployment, there are limited prospects for any improvement in 2012 given the deterioration of growth prospects.

Inflation and Bank Rate. For the last two years, the MPC's contention has been that high inflation was the outcome of temporary external factors and other one-offs (e.g. changes in VAT); that view remains in place with CPI inflation standing at 5.2% at the start of quarter 4 2011. They remain of the view that the rate will fall back to, or below, the 2% target level within the two year horizon.

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

4.3 Sector's forward view

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

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

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

Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK and the high volume of debt issuance in other major western countries.

Given the weak outlook for economic growth, Sector sees the prospects for any interest rate changes before mid-2013 as very limited. There is potential for the start of Bank Rate increases to be even further delayed if growth disappoints.

ANNEX 2. Specified and Non-Specified Investments
Eligibility Criteria for investment counterparties

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' quality criteria where applicable.

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the Specified Investment criteria.

A variety of investment instruments will be used. Subject to the credit quality of the institution and depending on the type of investment made, investments will fall into one of the above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

SPECIFIED INVESTMENTS
These investments are sterling investments of not more than one-year maturity or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are low risk investments where the possibility of loss of principal or investment income is small. These would include investments with:

1. The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
2. A local authority, parish council or community council.
3. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency.
4. A bank or building society that has been awarded a high credit rating by a credit rating agency.

Minimum credit ratings (as rated by Fitch, Moody's and Standard & Poors) and monetary and time period limits for all of the above categories are set out below. The rating criteria use the **lowest common denominator** method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one of which meets the Council's criteria while the other does not, the institution will fall outside the lending criteria. The Council will take into account other factors in determining whether an investment should be placed with a particular counterparty, but all investment decisions will be based initially on these credit ratings criteria. The Council will also apply a minimum sovereign rating of AA+ to investment counterparties.

NON-SPECIFIED INVESTMENTS
Non-specified investments are any other type of investment (i.e. not defined as Specified above) and can be for any period over 1 year. The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below.

	Non Specified Investment Category	**Limit (£ or %)**
a.	***Bank Deposits*** (with a maturity of more than one year) These can be placed in accordance with the limits of the Council's counterparty list criteria (i.e. subject to satisfaction of Fitch, Moody's and Standard & Poors credit ratings criteria shown below).	£40m group limit with Lloyds TSB and RBS, subject to eligibility criteria below.
b.	***Building Society Deposits*** (with a maturity of more than one year) These can be placed in accordance with the limits of the Council's counterparty list criteria (i.e. subject to satisfaction of Fitch, Moody's and Standard & Poors credit ratings criteria shown below).	None permitted at present.

c.	**Gilt edged securities** with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. The use of UK Government gilts is restricted to fixed date, fixed rate stock with a maximum maturity of five years. The total investment in gilts is limited to £25m and will normally be held to maturity, but the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity. The Finance Director must personally approve gilt investments. The Council currently has no exposure to gilt investments.	£25m.
d.	***Non-rated subsidiary*** of a credit-rated institution that satisfies the Council's counterparty list criteria. Investments with non-rated subsidiaries are permitted, but the credit-rated parent company and its subsidiaries will be set an overall group limit for the total of funds to be invested at any time.	Subject to group limit dependent on parent company's ratings.

CRITERIA FOR FUNDS MANAGED INTERNALLY AND EXTERNALLY

- **Banks General** - good credit quality **–** the Council may only use banks which:
  a) are UK banks;
  b) are non-UK and domiciled in a country with a minimum long-term sovereign rating of AA+;
  c) have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):

  - Short term – Fitch F1; Moody's P-1; S&P A-1
  - Long term – Fitch A-; Moody's A3; S&P A-

- **Banks 1A – UK and Overseas Banks (highest ratings)** - the Council may place investments up to a total of £30m for up to 1 year with UK banks that have at least the following Fitch, Moody's and Standard & Poors ratings (where rated) and £15m for up to 1 year with Overseas banks.

	Short-Term	Long-Term
Fitch	F1+	AA-
Moody's	P-1	Aa3
S & P	A-1+	AA-

Banks 1B – UK and Overseas Banks (very high ratings) - the Council may place investments up to a total of £20m for up to 1 year with UK banks that have at least the following Fitch, Moody's and Standard & Poors ratings (where rated) and £10m for up to 6 months with Overseas banks.

	Short-Term	Long-Term
Fitch	F1	A
Moody's	P-1	A1
S & P	A-1	A+

Banks 1C – UK and Overseas Banks (high ratings) – the Council may place investments up to a total of £10m for up to 6 months with UK banks that have at least the following Fitch, Moody's and Standard & Poors ratings (where rated) and £5m for up to 3 months with Overseas banks:

	Short-Term	Long-Term
Fitch	F1	A-
Moodys	P-1	A3
S & P	A-1	A-

- **Banks 2 - Part nationalised UK banks (Lloyds TSB and Royal Bank of Scotland)** - the Council may place investments up to a total of £40m for up to 2 years with the part-nationalised UK banks Lloyds TSB and the Royal Bank of Scotland provided their short and long-term ratings remain at least F1/A- (Fitch), P-1/A3 (Moodys) and A-1/A- (S&P).

- **Bank subsidiary and treasury operation** - The Council may use these where the parent bank has provided an appropriate guarantee and has the necessary ratings in Banks 1 above. The total investment limit and period will be determined by the parent company credit ratings.

- **Building societies** - The Council may use all societies that meet the ratings in Banks 1 above.

- **Sovereign Ratings –** The Council may only use counterparties in countries with sovereign ratings of AAA and AA+.

- **Money Market Funds –** The Council may invest in AAA rated Money Market Funds. The total invested in each of these Funds must not exceed £15m at any time.

- **UK Government (including gilts and the DMADF) –** The Council may invest in the government's DMO facility for a maximum of 1 year, but with no limit on total investment. The use of UK Government gilts is restricted to a total of £25m and to fixed date, fixed rate stock with a maximum maturity of 5 years. The Finance Director must personally approve gilt investments.

- **Local Authorities, Parish Councils etc –** The Council may invest with any local authority, subject to a maximum exposure of £15m for up to 2 years with each local authority.

- **Business Reserve Accounts** - business reserve accounts may be used from time to time, but value and time limits will apply to counterparties as detailed above.

ANNEX 3 Prudential and Treasury Indicators

Prudential and Treasury Indicators are relevant for the purposes of setting an integrated treasury management strategy and require the approval of the Council. They are included separately in Appendix 3 together with relevant narrative and are summarised here for submission to the Council meeting for approval.

The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The revised Code (published in 2009) was adopted by full Council on 15th February 2010.

PRUDENTIAL INDICATORS	2010/11	2011/12	2012/13	2013/14	2014/15	Page
	actual	estimate	estimate	estimate	estimate	
Total Capital Expenditure	£47.8m	£60.8m	£31.6m	£15.3m	£8.3m	13
Ratio of financing costs to net revenue stream	-2.6%	-1.3%	-1.5%	-2.0%	-2.0%	15
Net borrowing requirement (net investments for Bromley)						
brought forward 1 April	£133.9m	£161.0m	£143.0m	£143.1m	£139.6m	16
carried forward 31 March	£163.1m	£143.0m	£143.1m	£139.6m	£135.1m	16
in year borrowing requirement (movement in net investments for Bromley)	+£29.2m	-£18.0m	+£0.1m	-£3.5m	-£4.5m	16
Capital Financing Requirement as at 31 March	£7.5m	£7.2m	£6.9m	£6.6m	£6.3m	14
Annual change in Cap. Financing Requirement	-£0.3m	-£0.3m	-£0.3m	-£0.3m	-£0.3m	14
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**	**£ p**	**£ p**	
Increase in council tax (band D) per annum	-	-	-	-	-	15

TREASURY MANAGEMENT INDICATORS	2010/11	2011/12	2012/13	2013/14	2014/15	Page
	actual	estimate	estimate	estimate	estimate	
Authorised Limit for external debt -						
borrowing	£30.0m	£30.0m	£30.0m	£30.0m	£30.0m	17
other long term liabilities	£30.0m	£30.0m	£30.0m	£30.0m	£30.0m	17
TOTAL	£60.0m	£60.0m	£60.0m	£60.0m	£60.0m	17
Operational Boundary for external debt -						
borrowing	£10.0m	£10.0m	£10.0m	£10.0m	£10.0m	16
other long term liabilities	£20.0m	£10.0m	£10.0m	£10.0m	£10.0m	16
TOTAL	£30.0m	£20.0m	£20.0m	£20.0m	£20.0m	16
Upper limit for fixed interest rate exposure	100%	100%	100%	100%	100%	18
Upper limit for variable rate exposure	20%	20%	20%	20%	20%	18
Upper limit for total principal sums invested for more than 364 days beyond year-end dates	£37.5m	£80.0m	£80.0m	£80.0m	£80.0m	22