CAB2117
FOR DECISION
WARD(S): GENERAL

CABINET

9 February 2011

PRINCIPAL SCRUTINY COMMITTEE

14 February 2011

TREASURY MANAGEMENT STRATEGY 2011-12

REPORT OF HEAD OF FINANCE

Contact Officer: Alan Goard Tel No: 01962 848117 email: agoard@winchester.gov.uk

RECENT REFERENCES:

CAB1960 - Treasury Management Strategy 2010/11, 3 February 2010

CAB2042 - Treasury Management Stewardship 2009/10, 15 September 2010

CAB2079 - Treasury Management Mid Year Review 2010-11, 8 December 2010

EXECUTIVE SUMMARY:

This report outlines the Council's prudential indicators for 2011/12 – 2013/14 and sets out the expected treasury operations for this period. It fulfils four key reports required by the Local Government Act 2003:

1. The reporting of the **prudential indicators** setting out the expected capital activities, as required by the CIPFA Prudential Code for Capital Finance in Local Authorities. The treasury management prudential indicators are now included as treasury indicators in the CIPFA Treasury Management code of practice;
2. The **Treasury management statement**, which sets out how the Council's treasury service will support the capital decisions taken above, in accordance with the CIPFA Code of Practice on Treasury Management;
3. The **Investment Strategy**, which sets out the Council's criteria for choosing investment counterparties and limiting exposure to risk (in accordance with the DCLG investment guidance, revised 11 March 2010); and
4. The **Minimum Revenue Provision** Statement in accordance with DCLG Statutory Guidance.

The DCLG Investment guidance was revised on 11 March 2010 (effective from 1 April 2010) and is reflected in this report. The main changes were:-

- Makes it even clearer that investment priorities should be security and liquidity rather than yield
- Councils should consider submitting revised strategies during the financial year
- Strategies should be published
- Strategies should comment on the use of credit ratings and any additional sources of information on credit risk
- Strategies should comment on the use of treasury management advisors
- Strategies should comment on the investment of money borrowed in advance of spending needs

RECOMMENDATIONS to Cabinet, Principal Scrutiny Committee and Council :

1. That the Treasury Management Strategy 2011/12 as set out in this report be approved, including:

   - the adoption of the Prudential Indicators 2011/12-2013/14 setting out the expected capital activities (as required by the CIPFA Prudential Code for Capital Finance in Local Government) and the Treasury Management Prudential Indicators that are now in CIPFA Treasury Management Code of Practice.
   - A revision of the Capital Financing Requirement for 2010/11 (current year).
   - the Minimum Revenue Provision (MRP) Statement which sets out the Council's policy on MRP which sets out how the Council will pay for capital assets through revenue each year.
   - the Investment Strategy 2011/12 contained in the Treasury Management Strategy, and the detailed criteria included in Appendix A.

2. That Members note:

   - that the Strategy be kept under regular review to take account of any changes in the current global economic situation

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TREASURY MANAGEMENT STRATEGY 2011-12

REPORT OF HEAD OF FINANCE

1. Introduction

1.1 The Local Government Act 2003 requires the Council to adopt the CIPFA Prudential Code and produce prudential indicators. Each indicator either summarises the expected capital activity or introduces limits upon that activity, and reflects the outcome of the Council's underlying capital appraisal systems. This report updates currently approved indicators.

1.2 Key aspects of the system are the *Code of Practice for Treasury Management in the Public Service*s and the *Prudential Code for Capital Finance in Local Government*, both developed by the Chartered Institute of Public Finance and Accountancy (CIPFA), and the *Guidance on Local Government Investments* drawn up by the Department for Communities and Local Government (CLG) and the Minimum Revenue Provision from statutory guidance issued by CLG on 28 February 2008.

1.3 Revised DCLG Investment Guidance was issued on the 11 March 2010 effective from the 1 April 2010. The main changes were:-

i) Makes it even clearer that investment priorities should be security and liquidity rather than yield

ii) Councils should consider submitting revised strategies during the financial year

iii) Strategies should be published

iv) Strategies should comment on the use of credit ratings and any additional sources of information on credit risk

v) Strategies should comment on the use of treasury management advisors

vi) Strategies should comment on the investment of money borrowed in advance of spending needs.

1.4 The Council complies with these codes and the investment guidance.

1.5 The Housing Revenue Account subsidy system is currently under review. Latest figures available indicate that the Council will have to take on debt of circa £150m. This Strategy does not take into account these changes and it is expected that the strategy will need to be revised when final proposals are made by Central Government.

2. Treasury Management Policy Statement

2.1 The Council defines its treasury management activities as:

> The management of the Council's investment and cash flows, its banking, money market and capital market transactions; the effective control of risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

2.2 The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Council.

2.3 The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

3. Prudential Code

3.1 Local authorities determine their own programmes for capital investment in fixed assets that are central to the delivery of quality public services. The Prudential Code has been developed as a professional code of practice to support local authorities in taking their decisions. Local Authorities are required by Regulation to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003.

3.2 The key objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable. A further key objective is to ensure that treasury management decisions are taken in accordance with good professional practice and in a manner that supports prudence, affordability and sustainability.

4. Prudential Indicators

4.1 To demonstrate that local authorities have fulfilled these objectives, the Prudential Code sets out indicators that must be used and factors that must be taken into account. These indicators are designed to support and record local decision making in a manner that is publicly accountable.

4.2 The Prudential Code includes the following as required indicators for capital and control of borrowing:

- Capital Expenditure
- Capital Financing Requirement (CFR)
- A Minimum Revenue Provision (MRP) Statement
- Limits to Borrowing Activity

Capital Expenditure

4.2.1 The Council's capital expenditure plans are summarised below and this forms the first of the prudential indicators. This expenditure can be paid for immediately (by resources such as capital receipts, capital grants etc.), but if these resources are insufficient any residual expenditure will form a borrowing need.

The Council is asked to approve the summary capital expenditure projections below. This forms the first prudential indicator:

	2010/11	**2011/12**	**2012/13**	**2013/14**
	Revised	**Estimate**	**Estimate**	**Estimate**
	£million	**£million**	**£million**	**£million**
Capital Expenditure				
Non-HRA	8.5	14.1	2.0	2.2
HRA	4.5	6.5	4.7	4.7
Financed by:				
Non - HRA				
Government grants	0.4	0.4	0.4	0.4
External contributions	1.2	0.8	0.2	0.4
Earmarked reserves	1.5	0.5	0.4	0.4
Major Investment reserve	1.1	0.8	0.0	0.0
Capital receipts	2.5	2.0	1.0	1.0
HRA				
Major repairs allowance	3.4	3.9	3.6	3.6
Revenue Reserves	0.8	0.1	0.0	0.0
Capital Receipts	0.3	2.5	1.1	1.1
Net financing need for the year	**1.8**	**9.6**	**0.0**	**0.0**

The Council's Borrowing Need (the Capital Financing Requirement) and Minimum Revenue Provision Policy

4.2.3 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total outstanding capital expenditure which has not yet been funded from either revenue or capital resources. It is essentially a measure of Council's underlying borrowing need. Any capital expenditure above which has not immediately been funded will increase the CFR.

4.2.4 ***The Council is asked to approve the CFR projections below:***

	2010/11 Revised £million	**2011/12 Estimate £million**	**2012/13 Estimate £million**	**2013/14 Estimate £million**
Capital Financing Requirement				
CFR – Non Housing	(5.7)	3.9	3.6	3.2
CFR - Housing	10.1	10.1	10.1	10.1
Total CFR	**4.4**	**13.9**	**13.6**	**13.3**
Movement in CFR	**1.8**	**9.5**	**(0.3)**	**(0.3)**

Movement in CFR represented by				
Net financing need for the year (above)	1.8	9.6	0.0	0.0
MRP/VRP and other financing movements	0.0	(0.1)	(0.3)	(0.3)
Movement in CFR	**1.8**	**9.5**	**(0.3)**	**(0.3)**

4.2.5 The Council has positive CFR so it is required to pay off an element of the accumulated General Fund capital spend each year through a revenue charge (the Minimum Revenue Provision - MRP) and it is also allowed to undertake additional voluntary payments (VRP).

4.2.5.1 Additional Voluntary payments (VRP) will be considered on a project by project basis as they are brought forward

4.2.6 The Department of Communities & Local Government Regulations require the Full Council to approve an MRP Statement in advance of each financial year. A variety of options are provided to councils as long as there is a prudent provision.

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

For all unsupported borrowing the MRP policy will be:

- Asset Life Method – MRP will be based on the estimated life of the assets charged on an equal instalment basis, in accordance with the Regulations.

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

4.2.8 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (e.g. 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**	**2011/12**	**2012/13**	**2013/14**
	Revised	**Estimate**	**Estimate**	**Estimate**
	£million	**£million**	**£million**	**£million**
General Fund balance	2.0	2.0	2.0	2.0
HRA balances	1.4	1.1	1.1	1.1
Capital receipts	3.1	0.8	1.0	1.1
Earmarked reserves MIR	1.5	0.3	0.3	0.3
Earmarked reserves other	1.3	0.7	0.7	0.8
HRA Major Repairs reserve	0.9	0.6	0.6	0.6
Other Balances.	2.4	2.6	2.6	2.6
Total Core Funds	**12.6**	**8.1**	**8.3**	**8.5**
Working Capital	2.2	2.1	2.1	2.1
Capital Financing Requirement	(4.4)	(13.9)	(13.6)	(13.3)
Expected Investments/ (Borrowing)	10.4	(3.7)	(3.2)	(2.7)

Limits to Borrowing Activity

4.2.9 Within the prudential indicators there are a number of key indicators to ensure the Council operates its activities within well defined limits. For the first of these 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 2011/12 and the following two financial years.

£m	2010/11 Revised	2011/12 Estimated	2012/13 Estimated	2013/14 Estimated
Gross Borrowing	0.0	3.7	3.2	2.7
Investments	10.4	0.0	0.0	0.0
Net Borrowing	0.0	3.7	3.2	2.7
CFR	4.4	13.9	13.6	13.3

4.2.10 The Head of Finance reports that the Council has complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this year's Budget report.

4.2.11 A further two prudential indicators control or anticipate the overall level of borrowing. These are:

- The Authorised Limit for External Debt – This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by full Council.
- The Operational Boundary for External Debt –This indicator is based on the expected maximum external debt during the course of the year; it is not a limit.

4.2.12 ***The Council is asked to approve the following Authorised Limit and Operational Boundary:***

Authorised limit £m	2010/11 Revised	2011/12 Estimated	2012/13 Estimated	2013/14 Estimated
Borrowing	7.0	13.9	13.6	13.3
Other long term liabilities	0.0	0.0	0.0	0.0
Total	**7.0**	**13.9**	**13.6**	**13.3**

Operational Boundary £m	2010/11 Revised	2011/12 Estimated	2012/13 Estimated	2013/14 Estimated
Borrowing	2.0	8.9	8.6	8.3
Other long term liabilities	0.0	0.0	0.0	0.0
Total	**2.0**	**8.9**	**8.6**	**8.3**

4.2.13 An authorised limit of £7million for 2010/11 remains unchanged. The limits in the following years are proposed to increase in line with the Council's Capital Financing Requirement to enable (if necessary) the unfunded capital programme to be fully funded by external borrowing (in line with advice given by our treasury consultants).

4.3.13 An operational boundary is proposed at £5 million below authorised limit to allow for temporary cash flow needs, pending receipt of other funds. This is based on the Council's historic position.

4.3 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. The Council is asked to approve the following indicators:

4.3.1 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. The Non HRA (General Fund) is calculated using the Minimum Revenue Provision and Voluntary Revenue Contribution of the unfunded capital expenditure (Capital Financing Requirement). The HRA has a capital financing requirement (CFR) of £10.1m. The increase in the HRA % is due to the forecast of interest rates recovering from a historically low base. The HRA CFR remains fixed at the value computed when this issue was last addressed by CLG for the HRA subsidy system .

Affordability Indicator	**2010/11 Revised %**	**2011/12 Estimate %**	**2012/13 Estimate %**	**2013/14 Estimate %**
Non-HRA	0.2	0.5	2.3	2.3
HRA	0.3	0.3	0.8	1.3

4.3.2 Estimates of the incremental impact of capital investment decisions on the Council Tax – This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this Budget report compared to the Council's existing approved commitments and current plans.

4.3.3 Incremental impact of capital investment decisions on the Band D Council Tax, reflecting changes to the capital programme since last year's Treasury Management Policy approved by Council. This is a gain made up of the cumulative effect of interest gained on investments and the reduction of Minimum Revenue Provision (MRP).

	Proposed Budget 2011/12 £.p	**Forward Projection 2012/13 £.p**	**Forward Projection 2013/14 £.p**
Council Tax - Band D	(1.74)	3.44	4.40

4.3.4 Estimates of the incremental impact of capital investment decisions on Housing Rent levels – Similar to the Council tax calculation this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in this budget report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

4.3.5 Incremental impact of capital investment decisions Housing Rent levels:

	Proposed Budget 2011/12 £.p	**Forward Projection 2012/13 £.p**	**Forward Projection 2013/14 £.p**
Weekly Housing Rent levels	0.03	0.07	0.12

The major reason for the increase is the budgeted use of capital receipts balances on the Re-investment in stock condition project.

5. Treasury Management Strategy 2011/12 – 2013/14

5.1 The treasury management service is an important part of the overall financial management of the Council's affairs. The Investment Strategy's primary objectives are firstly to safeguard the re-payment of the principal and interest of its investments on time and secondly to ensure adequate liquidity – the investment return being a tertiary objective. The prudential indicators above consider the affordability and impact of capital expenditure decisions, and set out the Council's overall capital framework. The treasury service considers the effective funding of these decisions. Together they form part of the process which ensures the Council meets the requirement for a balanced Budget under the Local Government Finance Act 1992. There are specific treasury prudential indicators included in this strategy which require approval.

5.2 This strategy covers:

- The Council's debt and investment projections;
- The Council's estimates and limits on future debt levels;
- The expected movement in interest rates;
- The Council's borrowing and investment strategies;
- Treasury performance indicators;
- Specific limits on treasury activities.

6 Debt and Investment Projections 2011/12 – 2013/14

6.1 Based on the proposed capital programme (CAB2112) the Council's investments will diminish and the Council will go into debt at the end of 2011/12. The annual cash flow cycle is such that it is anticipated that the Council will be an investor again by early 2012/13 , this will repeat itself at the end of 2012/13 and 2013/14. It is anticipated that the Council will continue to be a net recipient of interest. As at 31 December 2010 short-term investments totalled £24 million and there was £1 million invested in the Local Authorities

Mutual Investment Trust (LAMIT) valued at £0.97million at 31 December 2010 (*see para 12 below).*

6.2 The projections are:

£m	**2010/11 Revised**	**2011/12 Estimate**	**2012/13 Estimate**	**2013/14 Estimate**
External Debt				
Debt at 1 April	0.0	0.0	3.7	3.2
Expected change in debt	0.0	3.7	(0.5)	(0.5)
Debt at 31 March	0.0	3.7	3.2	2.7
Operational Boundary	2.0	5.7	5.2	4.7
Investments				
Total Investments at 31 March	10.4	0	0.0	0.0
Investment change	(8.2)	(10.4)	0.0	0.0

6.3 Expected Movement in Interest Rates

Annual Average %	**Bank Rate**	**Money Rates**		**PWLB Rates***		
		3 month	**1 year**	**5 year**	**25 year**	**50 year**
2010/11	0.5	0.7	1.5	2.6	4.6	4.7
2011/12	0.7	0.9	1.8	3.5	5.3	5.3
2012/13	1.7	1.9	2.8	4.0	5.4	5.4
2013/14	3.1	3.3	3.8	4.8	5.6	5.6

* Borrowing Rates

6.4 Sensitivity to interest rate movement:- future Council accounts will be required to disclose the impact of risks on the Council's treasury management activity. Whilst most of the risks facing the treasury management service are addressed elsewhere in this report (credit risk, liquidity risk, market risk, maturity profile risk), the impact of interest rate risk is discussed but not quantified. The table below highlights the estimated impact of a 0.25% increase/decrease in all interest rates to the estimated treasury management costs/income for next year.

£000's (Increase)/Reduction in income	**2011/12 Estimated 0.25%**	**2011/12 Estimated -0.25%**
Revenue Budgets		
Related HRA Charge *	(17)	17
Net Investment income	(39)	39
Total effect on General Fund	(56)	56

* The effect on the HRA will be exactly opposite to the figures shown in the table i.e. the contra adjustment.

7. Borrowing Strategy 2011/12 – 2013/14

7.1 It is expected that the Council will need to externally borrow in 2011/12 to 2013/14. The Councils cash flow during the year is such that it is expected that the debt will only be incurred in March for less than a month. It is forecast that the Council will continue to have net investment income

7.2 Should there be any significant changes to this requirement during the year, for example as a consequence of further growth in the capital programme requiring borrowing, funding options will be presented for separate consideration and approval.

8. Investment Strategy 2011/12 – 2013/14

8.1. The Council's Investment Strategy's primary objectives are safeguarding the re-payment of the principal and interest of its investments on time first and ensuring adequate liquidity second – the investment return being a third objective.

8.2. The detailed counter party criteria are set out in Appendix A with the proposed changes in **bold text** and listed as follows:-

8.2.1. Local Authorities: no limit as a group (previously limited to £10m). At times during 2010-11 the Council ran out of active approved counterparties so was left with no option other than to invest in UK Governments Debt Management Office at very poor rates (0.25%). Local Councils offer better rates than the Debt Management Office.

8.2.2. Money Market funds - only AAA (previously only funds investing in UK Government securities). The rates offered by the UK Government funds are poor and we have not found it worth administration time to open any. The Council's investment portfolio is relatively small and short term so that amounts to be invested are below the thresholds for direct investments with AAA rated banks. The only way to access these top quality banks is by pooling our resources via an appropriate money market fund. As new bank liquidity rules are rolled out which make on call money a less attractive option for the banks it is the intention of managing the monthly cash flow peak of £8m via the money market funds and current account. Managing short term monthly cash is becoming more difficult as the total funds invested by the Council reduces, as there is less scope for rolling over longer term funds.

8.2.3. Northern Rock PLC, to be added to the list of 100% UK Government owned, as it is currently paying rates higher than Local Government, or the Debt Management Office.

8.2.4. National Westminster current account, additional £1m daily with the approval of Head of Finance. Staying within the current £3m limit involves aiming at a balance of £2.5m as we can never be sure of what receipts arrive later in the day. Allowing Head of Finance to authorise any excess over £3m will allow the Council to operate nearer the £3m limit at a time when we are receiving a competitive short term rate from our bank.

8.2.5. Tier 3, adding in a short term rating criteria as advised by our treasury management consultants. This means losing Co-op Bank as a counterparty as it is currently rated F2.

8.3. Risk Benchmarking – A development in the revised Codes and the CLG Investment Guidance is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are new requirements to the Member reporting, although the application of these is more subjective in nature. Additional background in the approach taken is attached at Annex B.

8.4. These benchmarks are simple guides to maximum risk and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year and Annual Report.

8.5. 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 meets the Council's criteria, 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.

Security

9. The CLG guidance makes a distinction between Specified and Non-specified investments:

9.1.1. ***Specified investments*** – offer high security and high liquidity and authorities can rely on them with "minimal procedural formalities". They are investments which:

- Are in sterling, and
- Mature within 364 days, and
- Are of a high credit quality.

9.1.2. Tiers 1-4 of the proposals are considered to be Specified Investments.

9.1.3. The credit ratings are monitored daily and should they drop below the level specified in Appendix B they will be removed from the counterparty list and will not be considered for investment. If money is already invested the Head of Finance will take a view on all circumstances. Under current market circumstances it is unlikely that early repayment is an option.

Under more normal market circumstances it is possible but there is a high cost attached.

9.1.4. ***Non-specified investments*** - are all those which do not qualify as "***specified"*** and therefore have greater potential risk.

9.1.5. These include the Council's investment in the Local Authorities Mutual Investment Trust, which is a long term investment at an historical cost of £1m.

10. Treasury Management Prudential Indicators and Limits on Activity

10.1. There are four further treasury prudential indicators the council is asked to approve.

	2011/12	**2012/13**	**2013/14**
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	100%	100%	100%
Limits on fixed interest rates			
• **Debt only**	100%	100%	100%
• **Investment only**	100%	100%	100%
Limits on variable interest rates			
• **Debt only**	100%	100%	100%
• **Investment only**	£5.0m	£5.0m	£5.0m
Maturity Structure of fixed interest rate borrowing 2011/12			
		Lower	**Upper**
Under 12 months		0%	100%
12 months to 2 years		0	£5.0m
2 years to 5 years		0	£5.0m
5 years to 10 years		0	£5.0m
10 years and above		0	£5.0m
Maximum principal sums borrowed			
Authorised limit	£13.9m	£ 13.6m	£13.3m
Maximum principal sums invested > 364 days			
Principal sums invested > 364 days	£2.0m	£2.0m	£2.0m

11. Treasury Management Practices

11.1. The Council has adopted suitable Treasury Management Practices setting out the manner in which it seeks to achieve the treasury management policies and objectives, and prescribing how it manages and controls those activities.

11.2. Performance Indicators

11.3. The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are:

- Debt – Borrowing - Average rate of borrowing for the year compared to average available
- Debt – Average rate movement year on year
- Investments – Internal returns above the Bank Base Rate.
- Investments – External fund managers - returns 110% above 7 day compounded LIBID.

Performance against these indicators will be reported in the Treasury Annual Report for 2011/12.

12. Other holdings:

12.1. Local Authorities' Mutual Investment Trust (LAMIT)

12.1.1. The Council currently holds 422,654 property fund units in the Local Authorities' Mutual Investment Trust (LAMIT), which were purchased in 1989/90 at a cost of £1million. The Fund objective is to generate long term growth in capital and a high and rising income over time. The value of the LAMIT is subject to market fluctuations. Performance over the past 5 years has been as follows:-

Valuation date	Value	Gain / (Loss) on investment (unrealised)	Gross Distribution for Year £
31st March 2006	£1,136,000*	136,000	63,977
31st March 2007	£1,527,000*	527,000	70,017
31st March 2008	£1,335,000*	335,000	64,747
31st March 2009	£ 821,000*	(189,000)	76,173
31st March 2010	£ 913,000*	(87,000)	59,896
31 December 2010	£ 970,000	(30,000)	Not Available

**Source: Statement of Accounts*

12.1.2. The latest quoted bid price (December 2010) is £0.97 million. The impairment was deferred in 2008-09 in the expectation that more normal markets would return.

12.1.3. Any decision as to whether to dispose or not should have due regard to any anticipated change in the capital value, future cash needs and anticipated dividends compared with yields from replacement investments. This investment will be kept under review and in the event that either the dividends fall below the benchmark rate or there is a significant change in the capital value (+/-20%) a formal review will be undertaken and options presented to the portfolio holder

12.1.4. The current annual yield based on historic cost is 5.8% (6.0% Last Year). This is dependant on property rents. Conditions in the market have stabilised but from a weak base, void levels remain uncomfortably high. This yield is not likely to be matched in the short term from rates obtainable on other investments.

12.1.5. When the Housing Revenue Account proposals become finalised it is possible that this long term investment will be disposed of to help fund the debt of circa £150m that is currently forecast to be incurred by the Council to buy our way out of the HRA subsidy system.

12.2. Investment in Heritable Bank Ltd (in Administration)

12.2.1. On 16 September 2008 the Council invested £1m in Heritable Bank plc, for a period of 6 months at a rate of 6%. Heritable is a Scottish registered company and a 100% subsidiary of (Old) Landsbanki.

12.2.2. Following the deterioration of the interbank lending markets, on 7 October 2008 the Iceland Government passed an Act that enabled the Icelandic Financial Services Authority to dismiss the board of Old Landsbanki and replace it with a Resolution Committee. On the same day the UK Government made the Heritable Bank Plc Transfer of Certain Rights and Liabilities Order 2008, which resulted in the transfer of Heritable's retail deposits to ING Direct NV. As a consequence, Heritable entered into Administration, and Ernst & Young LLP were appointed as administrators. Local Authorities' deposits with Heritable were not transferred to ING Direct NV under the terms of the Order and they became creditors in the administration of Heritable's estate.

12.2.3. To date the Council has received 6 distributions from the Administrator:

July 2009	£161,817
December 2009	£127,031
March 2010	£ 62,144
July 2010	£ 62,960
October 2010	£ 41,516
January 2011	£ 47,332
Total	**£502,800**

the next distribution is expected in March 2011.
The current forecast is that the Council will recover a further £297,200 by September 2012 making an 80% recovery of the original investment

12.2.4. The Council has also lodged a claim on the Heritable Bank's parent Landsbanki in respect of guarantee and indemnity provided. Test cases are provisionally listed in the Icelandic courts for 7 -15 February 2011

13. Treasury Management Advisors

13.1. The Council's treasury management consultants Butlers who were previously part of the ICAP group were transferred to Sector on the 20 October 2010. The consultants we dealt with on a regular basis moved to Sector. The consultants are now branded as Sector but the services remain unchanged. The company provides a range of services which include:

- Technical support on treasury matters, capital finance issues and the drafting of Member reports;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;
- Generic investment advice on interest rates, timing and investment instruments.

13.2. The Council is in the process of receiving quotes from suppliers of treasury management consultancy with a view to letting a new 4 year contract from the 1st April 2011. This is not related to the Sector take over of Butlers. The contract was due for renewal and it was a recommendation from the Treasury Management Informal Member Sub group that we should formally seek competitive quotations.

13.3. Whilst the advisors provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice the final decision on treasury matters remains with the Council. This service is subject to regular review.

OTHER CONSIDERATIONS:

14. SUSTAINABLE COMMUNITY STRATEGY AND CHANGE PLANS (RELEVANCE TO):

14.1. The Treasury Management Strategy supports all tenets of the Sustainable Community Strategy including the core value of being efficient and ensuring value for money.

15. RESOURCE IMPLICATIONS:

15.1. The unprecedented low interest rates continue to have a significant impact on the budget. The forecast interest rate for 2011/12 is only 0.9%. Rates are expected to start rising in the last quarter of 2011 but are not expected to reach more normal levels (3 – 4%) until 2013/14. A change in interest rate of 0.25% would alter investment income by circa £39,000 in 2011/12.

16. RISK MANAGEMENT

16.1. These are considered within the report

17. BACKGROUND DOCUMENTS

17.1. Operational and financial records held in the Finance Team.

17.2. Department of Communities & Local Government regulations on MRP Statement

http://www.local.communities.gov.uk/finance/capital/statguidmrp.pdf

17.3 Constitution, Financial Procedure Rules

18. APPENDICES:

Appendix A: Approved List of Financial Institutions and Investment Criteria effective from 1st April 2011

Appendix B: Security, Liquidity and Yield benchmarking

Appendix C: Ratings Definitions

Approved List of Financial Institutions and Investment Criteria

Classification	**Description**	**Institution**	**Requirements**	**Maximum total investment**
Tier 1	Investments with UK government	DMADF	6 months (max)	No limit
		Local Authorities	Max 364 days	**No limit** £2m per authority
		~~**UK Govt backed**~~ **AAA Money Market Funds**	**Long term rating of AAA with all three agencies where rated**	**£6m total** **£2m per fund**
Tier 2	Investments with UK Banks that have significant UK Government Shareholdings	Currently meeting criteria:- Lloyds Group Royal Bank of Scotland Group	Max 364 days	£3m per Group **£9m for Tier**
		Northern Rock PLC		
		Royal Bank of Scotland - National Westminster current account		and for National Westminster current account only - exceptionally an additional **£1m daily with approval by Head of Finance**
Tier 3	Investments with UK Banks that are Eligible Institutions of the 2008 Credit Guarantee Scheme.	Currently meeting criteria:- Barclays Close Brothers Group Clydesdale Bank ~~**Co-operative Bank**~~ HSBC N M Rothschild & Sons Santandar UK PLC Sumito Mitsui Corporation Group	**Short term Rating of F1 and above**, Long term rating of A and above with all three agencies*, where rated Max 364 days	£1m per institution £10m for Tier

Classification	Description	Institution	Requirements	Maximum total investment
		Standard Chartered Standard Life		
Tier 4	A Rated Investments with UK Building Societies that are Eligible Institutions of the 2008 credit Guarantee Scheme	Currently meeting criteria:- Coventry Leeds Nationwide Nottingham	Long term rating of A and above with all three agencies*, where rated Max 364 days	£1m per institution £10m for Tier

* Agencies:- Fitch
Moodys
Standard & Poors

Bold = changes proposed by this report

.See Paragraph 8.2 for detailed explanation of proposals

Security, Liquidity and Yield Benchmarking

Benchmarking and Monitoring Security, Liquidity and Yield in the Investment Service - A proposed development for Member reporting is the consideration and approval of security and liquidity benchmarks.

These benchmarks are targets and so may be breached from time to time. Any breach will be reported, with supporting reasons in the Annual Treasury Report.

Yield – These benchmarks are currently widely used to assess investment performance. Local measures of yield benchmarks are

- Investments – Internal returns above the bank rate

Security and liquidity benchmarks are already intrinsic to the approved treasury strategy through the counterparty selection criteria and some of the prudential indicators. However they have not previously been separately and explicitly set out for Member consideration. Proposed benchmarks for the cash type investments are below and these will form the basis of future reporting in this area. In the other investment categories appropriate benchmarks will be used where available.

Liquidity – This is defined as "having adequate, though not excessive cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives" (CIPFA Treasury Management Code of Practice). In respect of this area the Council seeks to maintain:

- Bank Balance / Liquid short term deposits of at least £2m available with one week's notice.

The availability of liquidity and the term risk in the portfolio can be benchmarked by the monitoring of the Weighted Average Life (WAL) of the portfolio – shorter WAL would generally embody less risk. In this respect the proposed benchmark is to be used:

- **WAL benchmark is expected to be 0.3 years, with a maximum of 0.8 years**.

Security of the investments – In context of benchmarking, assessing security is a much more subjective area to assess. Security is currently evidenced by the application of minimum credit quality criteria to investment counterparties, primarily through the use of credit ratings supplied by the three main credit rating agencies (Fitch, Moody's and Standard and Poors). Whilst this approach embodies security considerations, benchmarking levels of risk is more problematic. One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council's investment strategy. The table beneath shows average defaults for differing periods of investment grade products for each Fitch/Moody's Standard and Poors long term rating category over the period 1990 to 2009.

Years	1	2	3	4	5
AAA	0.00%	0.01%	0.05%	0.10%	0.17%
AA	0.03%	0.06%	0.08%	0.14%	0.20%
A	0.08%	0.22%	0.37%	0.52%	0.70%
BBB	0.24%	0.68%	1.19%	1.79%	2.42%
BB	1.22%	3.24%	5.34%	7.31%	9.14%
B	4.06%	8.82%	12.72%	16.25%	19.16%
CCC	24.03%	31.91%	37.73%	41.54%	45.22%

The Council's minimum long term rating criteria is currently "A", meaning the average expectation of default for a one year investment in a counterparty with a "A" long term rating would be 0.08% of the total investment (e.g. for a £1m investment the average loss would be £800). This is only an average - any specific counterparty loss is likely to be higher - but these figures do act as a proxy benchmark for risk across the portfolio.

The Council's maximum security risk benchmark for the whole portfolio, when compared to these historic default tables, is:

- **0.08% historic risk of default when compared to the whole portfolio.**

These benchmarks are embodied in the criteria for selecting cash investment counterparties and these will be monitored and reported to Members in the Investment Annual Report. As this data is collated, trends and analysis will be collected and reported. Where a counterparty is not credit rated a proxy rating will be applied.

Rating Definitions

Fitch – Short Term Ratings

F1

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

F2

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

Moody's – Short Term Ratings

Prime-1

Banks rated Prime-1 for deposits offer superior credit quality and a very strong capacity for timely payment of short-term deposit obligations.

Prime-2

Banks rated Prime-2 for deposits offer strong credit quality and a strong capacity for timely payment of short-term deposit obligations.

Standard & Poor's – Short Term Ratings

A-1

An obligor rated 'A-1' has STRONG capacity to meet its financial commitments. It is rated in the highest category by Standard & Poor's. Within this category, certain obligors are designated with a plus sign (+). This indicates that the obligor's capacity to meet its financial commitments is EXTREMELY STRONG.

A-2

An obligor rated 'A-2' has SATISFACTORY capacity to meet its financial commitments. However, it is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors in the highest rating category.

Fitch – Long Term Ratings

AAA Highest credit quality.

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

AA Very high credit quality.

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

A High credit quality.

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

Note: "+" or "-" may be appended to a rating to denote relative status within major rating categories. Such suffixes are not added to the 'AAA' Long-term rating

Moody's – Long Term Ratings

Aaa
Banks rated Aaa for deposits offer exceptional credit quality and have the smallest degree of risk. While the credit quality of these banks may change, such changes as can be visualized are most unlikely to materially impair the banks' strong positions.

Aa
Banks rated Aa for deposits offer excellent credit quality, but are rated lower than Aaa banks because their susceptibility to long-term risks appear somewhat greater. The margins of protection may not be as great as with Aaa-rated banks, or fluctuations of protective elements may be of greater amplitude.

A
Banks rated A for deposits offer good credit quality. However, elements may be present that suggest a susceptibility to impairment over the long term.

Note: Moody's applies the numerical modifiers 1, 2, and 3 in each generic rating category from Aa to Caa. The modifier 1 indicates that the bank is in the higher end of its letter-rating category; the modifier 2 indicates a mid-range ranking; and the modifier 3 indicates that the bank is in the lower end of its letter-rating category.

Standard & Poor's – Long Term Ratings

AAA
An obligor rated 'AAA' has EXTREMELY STRONG capacity to meet its financial commitments. 'AAA' is the highest Issuer Credit Rating assigned by Standard & Poor's.

AA
An obligor rated 'AA' has VERY STRONG capacity to meet its financial commitments. It differs from the highest rated obligors only in small degree.

A
An obligor rated 'A' has STRONG capacity to meet its financial commitments but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors in higher-rated categories.

Note: Plus (+) or minus (-) The ratings from 'AA' to 'CCC' may be modified by the addition of a plus or minus sign to show relative standing within the major rating categories.

Fitch – Individual Rating

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

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

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

Note: In addition, we use gradations among these five ratings, i.e. A/B, B/C, C/D, and D/E.

Moody's – Financial Strength Rating

A
Banks rated A possess superior intrinsic financial strength. Typically, they will be institutions with highly valuable and defensible business franchises, strong financial fundamentals, and a very predictable and stable operating environment.
B
Banks rated B possess strong intrinsic financial strength. Typically, they will be institutions with valuable and defensible business franchises, good financial fundamentals, and a predictable and stable operating environment.
C
Banks rated C possess adequate intrinsic financial strength. Typically, they will be institutions with more limited but still valuable business franchises. These banks will display either acceptable financial fundamentals within a predictable and stable operating environment, or good financial fundamentals within a less predictable and stable operating environment.

Note: The definitions for Moody's Bank Financial Strength Ratings employ the alphabetic notation A through E as well as the symbols + and - to indicate gradation.

Fitch – Support Rating

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

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

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

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

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

Support Rating Floor
Support Rating Floors are directly derived from the agency’s Support Ratings in those cases where the Support Rating is based on potential sovereign support. In exactly the same way as the Support Rating itself, the Support Rating Floor is based on the agency’s judgment of a potential supporter’s propensity to support a bank and of its ability to support it. Support Rating Floors do not assess the intrinsic credit quality of a bank. Rather they communicate the agency’s judgment on whether the bank would receive support should this become necessary. It is emphasized that these ratings are exclusively the expression of Fitch Ratings’ opinion even though the principles underlying them may have been discussed with the relevant supervisory authorities.

The Support Rating Floor is expressed on the ‘AAA’ long-term scale, and will clearly indicate the level below which the agency would not expect to lower its Issuer Default Rating in the absence of any changes to the assumptions underpinning the bank’s Support Rating. In addition to the ‘AAA’ scale, there will be one additional point on the scale – “No Floor” (NF) – which indicates that in the agency’s opinion, there is no reasonable presumption of potential support being forthcoming. In practice this approximates to a probability of support of less than 40%.

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