

STRATEGY / POLICY FRONT COVER

Name of Strategy / Policy: Treasury Management Strategy

Date last updated: February 2010

Date last revised and reasons for revision:

February 2010 – the Strategy has to be approved by Council annually and has been updated to take account of the changes in the Code of Practice for Treasury Management in the Public Services issued by the Chartered Institute of Public Finance and Accountancy (CIPFA), updated in November 2009.

Links to Council Priorities:

Priority	Linked Yes / No?
Environment – Civic Pride	No
Regeneration and Homes	No
Improving the Council	Yes
Community Safety	No

Links to Other Strategies and Policies

Financial Planning and Capital Strategy.

Action Plan in this document?

Implement recommendations in the Code of Practice including risk benchmarking, additional reporting and training, and updating Treasury Management Practices.

Name of lead officer responsible for implementing the action plan:

Chris Mills is responsible for the Strategy and for ensuring adequate monitoring and reporting.

Name of lead Member and Member body responsible for monitoring implementation of the action plan:

Cllr Jeffrey Stanley – Cabinet Member for Corporate Policy, Resources and Performance. Audit Committee and Cabinet receive mid-year and annual reports.

Equality impact assessment undertaken?: No

Sustainability appraisal undertaken?: No

Policy register on N Drive updated?: Yes



Castle Point Borough Council

Treasury Management Strategy for 2010/11

Produced by: Financial Services Manager.

Subject to Annual Review

Approved by:

- Executive Management Team: February 2010
- Cabinet: 16th February 2010

12 Treasury management

Treasury management

1 Treasury management is:-

“The management of the organisation’s cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”

2 One of the capital Prudential Indicators is that the Council must comply with the Code of Practice for Treasury Management in the Public Services as issued by the Chartered Institute of Public Finance and Accountancy (CIPFA). The code of practice was updated in November 2009 and now includes recommendations that the Council incorporates the following Treasury Management clauses within its Constitution:

The Council:

1 Will create and maintain, as the cornerstones for effective treasury management:

- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities.
- Suitable treasury management practices, setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

2 Will receive reports on its treasury management policies, practices and activities, including as a minimum, an annual strategy and plan in advance of the year, a mid year review and an annual report after its close, in the form prescribed in its TMPs.

3 Delegates responsibility for the implementation and monitoring of its treasury management policies and practices to Cabinet, and for the execution and administration of treasury management decisions to the Head of Resources, who will act in accordance with the Council's policy statement and TMPs and CIPFA's Standard of Professional Practice on Treasury Management.

4 Nominates Cabinet to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

3 The Council already complies with these requirements and amendment of the constitution will ensure full compliance with the requirements of the code of practice.

Treasury management strategy for 2010/11

4 The strategy has been formulated after considering the advice of the Council’s consultants, Butlers. All activity envisaged by the strategy will be in accordance with the Treasury Management Policy Statement. Officers are required to follow policies and procedures.

Prospects for interest rates

5 Short-term rates are expected to increase from 0.50% to 1% by the end of 2010. With inflation set to remain subdued in the next few years, the pressure upon the Monetary Policy Committee to increase rates will remain moderate. Longer term rates are expected to be more volatile. The current ‘softness’ of gilt yields & PWLB rates may continue for a while yet, given that these are being driven by a benign international backdrop and the effects of Quantitative Easing (QE). Nevertheless this process will come to an end before the close of the financial year.

This is likely to be a return to rising yields for a number of reasons:

- Net gilt issuance will rise sharply;
- This will be increased by the extent to which the Bank of England attempts to claw back funds injected in to the economy via the QE programme;
- Investors will be looking to place more of their funds in alternative instruments as their risk appetite increases, demand for gilts will weaken as a consequence;
- A decision to leave QE in place will generate inflation concerns and pressurise long yields higher.

It is expected that the 40-50yr PWLB long-term rate for maturity loans will be around 5.2% during 2010/11.

Current debt position and requirements for 2010/11

6 A summary of external debt that will be outstanding at 31 March 2010 is:-

Table 12.1 External debt outstanding	
Source	Total at 31/3/2010 £
Public Works Loan Board	7,825,112

7 All of the Council's debt consists of fixed rate loans at interest rates ranging from 3.7% to 9.375% per annum. If they are repaid prematurely, they attract either a premium or discount depending on the relationship between the interest rate of the loan and market rates and also the unexpired period at the time of repayment.

The Council has no debt maturing in 2010/11. This means that if there is no new or replacement borrowing, outstanding debt will remain the same and repayable in full, at maturity.

8 External borrowing can arise as a consequence of all the financial transactions of the authority and not simply those arising from capital spending. The proposed programme of capital expenditure set out at table 11.3 could therefore trigger a requirement for new borrowing in 2010/11. Section 11, paragraph 22 above provides confirmation of the prudential position for future years, based on current estimates.

Borrowing strategy

9 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.

10 Long-term fixed interest rates are at risk of being higher over the medium term, and short term rates are expected to rise, although more modestly. The Head of Resources, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above. It is likely that shorter term fixed rates may provide lower cost opportunities in the short/medium term.

11 With the likelihood of long term rates increasing, debt restructuring is likely to focus on switching from longer term fixed rates to cheaper shorter term debt, although the Head of Resources and treasury consultants will monitor prevailing rates for any opportunities during the year.

12 The option of postponing borrowing and running down investment balances will also be considered. This would reduce counterparty risk and hedge against the expected fall in investments returns.

Borrowing in advance of need

- 13 The Council has some flexibility to borrow funds this year for use in future years. The Head of Resources may do this under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. Whilst the Head of Resources will adopt a cautious approach to any such borrowing, where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities.
- 14 Draft CLG guidance, which may not be adopted in the final guidance, has determined that the setting of constraints for any borrowing in advance of need is considered good practice. The Head of Resources does not currently anticipate any need to borrow in advance of need, but if circumstances change then borrowing in advance will be made within the constraints that:
- It will be limited to no more than £2m of the expected increase in borrowing need (CFR) over the three year planning period; and
 - The Council would not look to borrow more than 18 months in advance of need.

Risks associated with any advance borrowing activity will be subject to appraisal in advance and subsequent reporting through the mid-year or annual reporting mechanism.

Borrowing maturity structure

- 15 The Prudential Code requires the Council to set upper and lower limits for the maturity structure of fixed rate borrowing. These limits are designed to help the Council minimise its exposure to large fixed rate sums falling due for refinancing. The proposed limits, expressed as percentages of total projected fixed rate borrowing, are as follows:-

Maturity	Upper limit	Lower limit
	%	%
Under 12 months	50	0
12 months and within 2 years	50	0
2 years and within 5 years	60	0
5 years and within 10 years	80	0
10 years and above	100	0

Borrowing – limits of fixed and variable rate exposure

- 16 The Prudential Code requires the Council to set upper limits for fixed and variable interest rate exposure. These indicators identify the maximum limits for both fixed and variable interest rates based upon the Council's debt position net of investments. The proposed limits are as follows:-

	2009/10	2010/11	2011/12	2012/13	2013/14
	£'m	£'m	£'m	£'m	£'m
Upper limit – fixed rates	10	10	10	10	10
Upper limit – variable rates	-5	-4	-1	0	0

Borrowing - interest rate sensitivity

- 17 Any borrowing decisions will need to take account of any sudden changes in interest rates.

There are two possible scenarios:

- a sudden sharp rise in rates – if this is considered possible, any fixed interest borrowing will be taken while interest rates are relatively low;

- a sudden sharp fall in rates – if this is expected, any borrowing will be postponed (waiting for borrowings to become cheaper) and rescheduling from fixed to variable rate funding will be considered.

Borrowing objectives

18 A summary of our borrowing objectives for the year is therefore as follows:

- to borrow if necessary in order to finance cash flows arising from capital expenditure in accordance with the Prudential Code;
- to reduce, if possible, the amount of long-term borrowing without incurring net losses for early redemption (taking into account any impact on housing subsidy);
- to manage the debt maturity profile in order to avoid a high level of repayments in any one year;
- to borrow at the best interest rates achievable in relation to estimated future rates;
- to monitor and review the level of any variable interest rate loans in order to take advantage of interest rate movements;
- if possible, to reschedule debt in order to take advantage of potential savings as interest rates change (but after assessing the impact on housing subsidy);
- to avoid as far as possible, excessive overdrawn bank balances by achieving a balanced daily cash position, unless market borrowing proves favourable by comparison;
- to ensure that overall borrowing is within the authorised limit for external debt and that this is monitored on a regular basis.

13 Investment Strategy

1 This Council has regard to the CLG's Guidance on Local Government Investments ("Guidance") and CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("CIPFA TM Code").

Investment Principles

2 All investments will be in sterling. The general policy objective for this Council is the prudent investment of its treasury balances. The Council's investment priorities are (a) the **security** of capital (protecting the capital sum from loss) and (b) **liquidity** of its investments (keeping the money readily available for expenditure when needed).

3 Provided that proper levels of security and liquidity are achieved, it may then (but only then) be reasonable to seek the highest **yield** consistent with those priorities.

4 The Guidance maintains that the borrowing of monies purely to invest or lend on and make a return is unlawful and this Council will not engage in such activity.

Specified and Non-Specified Investments

5 Specified investments are high security, high liquidity investments in sterling with very high credit quality, and with a maturity of no more than a year. Specified investment instruments identified for use in the financial year are listed in table 13.1.

6 Non-Specified investments are any other type of investment, i.e. not defined as Specified above and those identified for use in the financial year are listed in table 13.2. The Council does not intend to invest in "non-specified" investments, other than the Co-operative Bank, who are the Council's current bankers. The Co-op Call Account is used for day to day surplus funds, and funds are available on demand, rather than being invested for a fixed period. Any non-specified investments are closely monitored and controlled and the Council's internal temporary investment guidance may impose further restrictions on their use if required. As stated in table 13.2 the total invested in the Co-op Call Account is limited to the lesser of £4m or 25% of total investments.

Liquidity

7 Based on its cash flow forecasts, the Council anticipates its fund balances in the financial year 2010/11 to range between £6.2m and £16.5m.

8 Table 13.1 sets out the maximum periods for which funds may be prudently committed in each asset category.

Investment Risk and Creditworthiness

9 Credit quality of counterparties (issuers and issues) and investment schemes will be determined mainly by reference to credit ratings published by Fitch, Moody's and Standard & Poors. In compliance with the CIPFA Treasury Management Panel recommendation in March 2009 and the CIPFA Treasury Management Code of Practice, the rating criteria use the lowest common denominator method of selecting counterparties and applying limits. Table 13.1 sets out the Council's minimum credit ratings that it considers appropriate for each category of investment. All investments, other than those placed on the Co-op Call account for day to day cash flow requirements are invested in institutions with very high long-term credit ratings (minimum AA-) or in money market funds with the highest possible rating (AAA or equivalent).

10 Monitoring of credit ratings:

- All credit ratings will be monitored monthly or when deposits are made. The Council's external adviser, Butlers, also alerts the Council to changes in ratings as they occur.

- If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- If a counterparty/investment scheme is upgraded so that it fulfils the Council's criteria, the s151 Officer will have the discretion to include it on the lending list.

Country, group and sector limits

- 11 The Council selects counterparties according to credit quality rather than nationality, since the former is a better guide to security as the recent credit crisis has shown. Consequently no country limits are stipulated. In practice the Council currently only invests in UK-regulated banks and building society, or funds which adopt the Institutional Money Market Funds Association (a trade body for European fund managers) Code of Conduct for triple-A rated funds. The funds are domiciled in the United Kingdom, Ireland or Luxembourg. The Council will only invest in jurisdictions and institutions where the financial sector is, in the opinion of the s151 Officer, thought to be well regulated and relatively secure.

Group and sector limits do not form part of the formal investment strategy, but are used within the temporary, stricter investment guidance described in paragraph 13.

Use of additional information other than credit ratings

- 12 Additional requirements under the Code of Practice now require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example equity prices, Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

Banking Crisis: Temporary Guidance

- 13 Due to uncertainty in the money markets and the lack of confidence in counterparties, from September 2008 the Council adopted temporary stricter investment guidance than laid out in the Investment Strategy, such as lower counterparty limits. The situation is reviewed every time the Council has surplus funds to invest, taking into account information and advice supplied by Butlers, the Council's treasury adviser. Changes to the guidance are decided by the Head of Resources. These measures may remain in place for as long as they are required.

Investments defined as capital expenditure

- 14 The acquisition of share capital or loan capital in any corporate body is defined as capital expenditure under Regulation 25(1) (d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003. Such investments will have to be funded out of capital or revenue resources and will be classified as 'non-specified investments'. As already stated, the Council does not currently intend to invest in "non-specified" investments other than the Co-op Call Account.
- 15 Investments in "money market funds" which are collective investment schemes and bonds issued by "multilateral development banks" with a maturity of less than one year – both defined in SI 2004 No 534 – will not be treated as capital expenditure.
- 16 A loan or grant or financial assistance by this Council to another body for capital expenditure by that body will be treated as capital expenditure.

Provisions for credit-related losses

- 17 If any of the Council's investments appeared at risk of loss due to default (i.e. this is a credit-related loss and not one resulting from a fall in price due to movements in interest rates) the Council will make revenue provision of an appropriate amount.

Investment Strategy to be followed in-house

- 18 The Council's in-house managed funds are mainly cash flow derived. Due to the low level of these funds the Council has no proposals to invest for periods over 364 days. Investments will accordingly 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).

Risk Benchmarking

- 19 A development in the revised Codes and the CLG consultation paper 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.

- 20 These benchmarks are simple targets (not limits) 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 depending on any changes. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report. Use of these benchmarks will be reviewed and they may be amended or added to if necessary.

- 21 Security - The Council's maximum security risk benchmark for the current portfolio is:

- A credit-rating score of 4.0 for the overall investment portfolio. Each investment is given a score according to long-term credit rating (eg. 7 for AAA, 4 for AA-, 1 for A-) and then weighted according to amount.

- 22 Liquidity – In respect of this area the Council seeks to maintain:

- Bank overdraft - £200,000. Higher overdraft facilities are available on request from the Co-op.
- Liquid short term deposits of at least £1.5m available with a day's notice.
- Weighted Average Life benchmark is expected to be up to 2 months, with a maximum of one year.

- 23 Yield - Local measures of yield benchmarks are:

- Investments – Internal returns above the 7-day LIBID rate

Treasury Management Adviser

- 24 Butlers was re-appointed as the Council's treasury adviser in August 2009 for a period of three years. The company provides a range of services which include technical support on treasury matters and capital finance issues; economic and interest rate analysis; debt rescheduling advice surrounding the existing portfolio; investment advice on interest rates, timing and investment instruments; credit ratings/market information service comprising the three main credit rating agencies; and data from international money markets.

- 25 Whilst the adviser provides 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.

Member and Officer Training

- 26 The increased Member consideration of treasury management matters and the need to ensure officers dealing with treasury management are trained and kept up to date requires a suitable training process for Members and officers. It is anticipated that relevant Members will receive training by March 2010. Treasury staff attend appropriate courses and seminars held by CIPFA and Butlers to both maintain and improve their knowledge and expertise.

Investment Activity Reporting

- 27 At the end of the financial year, the Council will prepare a report on its investment activity as part of its Annual Treasury Report, and a new requirement of the revision of the Code of Practice is that there is a mid-year monitoring report.

Additional Reporting

- 28 Whilst there is a requirement to present the Investment Strategy to a meeting of Council at least annually, this does not preclude more frequent reporting should changes or circumstances dictate. However, changes to the Investment Strategy may not be limited to those circumstances outlined in the original document. If necessary the Investment Strategy will be revised if any elements of the final CLG Investment Guidance have not already been covered.

Publication

- 29 The latest version of the Council's Investment Strategy will be published on the Council's website.

13 Investment Strategy

All “Specified Investments” listed below must be sterling-denominated.

Table 13.1 Specified Investments for the Financial Year 2010/11

Investment	Share/ Loan Capital?	Counterparty limit	Security / Minimum Credit Rating	Capital Expenditure?	Circumstance of use	Maximum period
Debt Management Agency Deposit Facility (DMADF) (this facility is at present available for investments up to 6 months)	No	No limit	Agency of the UK Government	No	In-house	6 months (DMO imposed time limit)
Term deposits with the UK government or with UK local authorities (i.e. local authorities as defined under section 23 of the 2003 Act)	No	The lesser of £5m or 33% of total investments	High quality as either directly invested or via agencies of UK Government. (Although local authorities are not specifically credit rated)	No	In-house	364 days
Term Deposits with institutions guaranteed by AAA-rated governments	No	The lesser of £5m or 33% of total investments	Guaranteed by sovereign countries which have AAA long-term ratings from all three main agencies (Fitch, Moody's and Standard & Poors). Maturity before expiry of guarantee	No	In-house	364 days
Money Market Funds (i.e. a collective investment scheme as defined in SI 2004 No 534) These funds do not have a maturity date	No	The lesser of £5m or 33% of total investments	Fitch, Moody's or Standard and Poors AAA (Minimum of two ratings)	No	In-house	N/A (repayable on demand)
Term deposits with credit-rated deposit takers (banks and building societies), including callable deposits	No	The lesser of £5m or 33% of total investments	long-term AA-, short-term F1+ (lowest common denominator Fitch, Moody's & S&P)	No	In-house	364 days (Call deposits repayable on demand)

Table 13.1 Specified Investments for the Financial Year 2010/11 (continued)						
Forward deals with credit rated banks and building societies < 1 year (i.e. negotiated deal period plus period of deposit).	No	The lesser of £5m or 33% of total investments	long-term AA-, short-term F1+ (lowest common denominator Fitch, Moody's & S&P)	No	In-house	364 days

Table 13.2 Non-specified Investments for the Financial Year 2010/11						
Co-op Call Account Co-op are the Council's current bankers. The Call account is used for daily cashflow requirements.	No	The lesser of £4m or 25% of total investments	Funds are repayable on demand. If ratings are downgraded then a lower limit and/or alternative accounts or investments will be considered	No	In-house	N/A (repayable on demand)

